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**ABANDONED IDEOLOGY: HOW THE IRANIAN
REVOLUTION FAILED ISLAMIC ECONOMICS AND
EMBRACED POPULISM**

by

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September 2010

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ISLAMIC ECONOMICS AND EMBRACED POPULISM**

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ABSTRACT

In the three decades since the Islamic revolution overturned the Pahlavi regime and ushered in the Islamic Republic, the world has seen the effects, not of Shi'a Islamic philosophy constituted as government, but more accurately of the personal vision of Ayatollah Khomeini regarding the state. While Khomeini promised the regime to be the embodiment of Islamic social justice, the reality was a failure to deliver a consistent philosophy of Islamic government that could survive after his death. In no area was that more evident than the economy.

The formation of the Islamic government in Iran offered the potential for one of the first modern examples of Islamic economic theory instituted on a national scale. The ideology had been well thought out by some scholars, and was fully in keeping with the espoused ideas of equality and social justice of the revolution. The implementation was never fulfilled, however, due to Khomeini's lack of interest in economic theory writ large, the influence of left-leaning populist elements of the revolution and early Islamic government, and Khomeini's creation of perennially deadlocked institutions of government. As a result, Iran has followed the same path of poor economic development common to most hydrocarbon rentier states.

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TABLE OF CONTENTS

I.	INTRODUCTION.....	1
A.	RESEARCH QUESTION	1
B.	IMPORTANCE.....	1
C.	PROBLEMS AND HYPOTHESIS	3
D.	LITERATURE REVIEW	4
E.	METHODS AND SOURCES.....	11
F.	THESIS OVERVIEW	11
II.	“WESTERN” AND ISLAMIC ECONOMIC THEORY	13
A.	ECONOMIC DEVELOPMENT THEORY	13
B.	THE ORIGINS OF ISLAMIC ECONOMICS	15
C.	ISLAMIC ECONOMICS AND FINANCE: CURRENT PRACTICES AND ISSUES	19
1.	The Public Sector: Financing the Government.....	19
2.	The Private Sector: Islamic Finance	21
III.	IRANIAN IDEOLOGY: THE ROLE OF ISLAM, GOVERNMENT, AND ECONOMICS	29
A.	FOUNDATIONS OF CONTEMPORARY ECONOMIC POLICY IN IRAN	29
1.	Centralized Planning: The Sole Survivor of the Pahlavi State.....	29
2.	Khomeini’s Personal Beliefs.....	29
B.	IRAN’S VERSION OF ISLAMIC ECONOMIC GOVERNANCE.....	31
1.	Competing Visions Within the 1979 Islamic Revolution Regarding Islamic Economics.....	31
2.	Iranian Economics Following the Revolution: Idealism Becomes Authoritarian Populism.....	34
IV.	THE IRANIAN ECONOMY (1979–2009).....	45
A.	THE ECONOMY BEFORE THE ISLAMIC REVOLUTION	45
B.	THE IRAN-IRAQ WAR	46
C.	ECONOMIC DEVELOPMENT AFTER THE IRAN-IRAQ WAR.....	48
1.	The First Development Plan: 1989–1993	48
2.	The Second Development Plan: 1995–2000	51
3.	The Third Development Plan: 2000–2005	53
4.	The Fourth Development Plan: 2005–2009	56
a.	Economic Growth	57
b.	Price Stability	58
c.	Unemployment	59
d.	Increased Investment	60
e.	Reduced Dependence on Oil.....	61
D.	RELATIVE DEVELOPMENT SUCCESSES	61
E.	DEVELOPMENTAL FAILURES	63

V.	CONCLUSION	67
A.	OIL MEANS MONEY, NOT DEVELOPMENT	68
B.	THE DELETERIOUS EFFECT OF SANCTIONS	69
C.	THE END OF THE REVOLUTION FOR ISLAMIC ECONOMICS IN IRAN	70
	LIST OF REFERENCES	73
	APPENDIX A: TARGETS AND OUTCOMES OF SECOND DEVELOPMENT PLAN.....	77
	APPENDIX B: ECONOMIC PERFORMANCE DURING THE FOURTH DEVELOPMENT PLAN	79
	APPENDIX C: ECONOMIC PERFORMANCE DURING THE THIRD DEVELOPMENT PLAN	81
	APPENDIX D: MONETARY TARGETS.....	83
	APPENDIX E: THIRD AND FOURTH DEVELOPMENT PLAN ECONOMIC DEVELOPMENT INDICATORS.....	85
	INITIAL DISTRIBUTION LIST	89

LIST OF FIGURES

Figure 1.	Oil price per barrel (in USD). Highlighted period reflects period covered by First Development Plan. From U.S. Energy Information Administration, 2007	49
Figure 2.	Macroeconomic figures for Iran. Source: Oxford Economic Country Briefings.....	58
Figure 3.	Iranian inflation compared with that of MENA overall. From Oxford Economics/World Bank	59
Figure 4.	Unemployment rate trends in Iran. From Index Mundi data provided by figures in CIA World Fact Book.....	60
Figure 5.	Economic performance during the Fourth Development Plan. From Economist Intelligence Unit (CIAO/EIU Partnership).....	79

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LIST OF TABLES

Table 1.	Targets and outcomes of Second Development Plan.....	77
Table 2.	Performance of the Iranian economy during the Third Development Plan. From Amuzegar	81
Table 3.	Islamic Republic of Iran monetary targets, 1989/90–2004/5. From IMF Country Report No. 04/308.....	83
Table 4.	Iran development indicators for Third and Fourth Development periods. From World Trade Database, 2009.....	85

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I. INTRODUCTION

A. RESEARCH QUESTION

This thesis seeks to answer the question: “Is the failure of economic development in Iran since the 1979 Islamic Revolution caused by an inherent failure of the ideology of Islamic economics, or is it a classical case of the usual failings of a hydrocarbon rentier state?” Iran, as an Islamic Republic, potentially stood as a practical example of the implementation of Islamic economic theory and practices on a national scale. Implicit within this question is the examination of specific economic development issues within Iran, and an analysis of both the potential effectiveness of the proposed solutions, as well as an examination of the ultimate barriers that hindered the success of those plans. This thesis will measure economic development, in the case of Iran, in terms of the reduction of the direct participatory role of government in the economy, the enhancement of the private sector’s share of economic activity, and (most critically) the diversification of the economy from the hydrocarbon rentier state paradigm.

Additionally, this thesis will examine the history of economic development in Iran following the 1979 Islamic Revolution and pay particular attention to the attempts at development reform following the conclusion of the Iran-Iraq war. This examination will lay the foundation for understanding the general challenges previous Iranian administrations faced in advancing economic development, and will serve as a baseline from which to measure the continuation—or lack thereof—of real reforms by the Ahmadinejad government.

B. IMPORTANCE

Iran stands today at the nexus of most major political events within the wider Middle East. Iran’s foreign policy, and military, cultural and economic activities influence Iraq and Afghanistan, the tension and conflict between Israelis and Palestinians, and overall security and politics in the Arabian Gulf. Iran possesses a long and rich cultural legacy that predates Islam, and its status as the world’s only *shi’a* Islamic-

governed nation is a unique model for the confluence of religion and politics. The significance of this is that success or failure of economic development in Iran has serious implications, not just for the living conditions of Iranians, but for the United States' foreign policy in the Middle East.

Following the Islamic Revolution of 1979, the Iranian government took a greater participatory role in the economy through the nationalization of most industries. Critically, the Islamic nature of the revolution and the government that followed meant that all aspects of Iran were modeled on Islamic theory and ideology, including the economy. Thus, Iran potentially serves as a unique model of a comprehensive Islamic economic system. However, Iran also possesses 10% of the world's oil reserves (third largest) and has built its economy almost solely around this commodity.¹ As a result, Iran traditionally has relied on hydrocarbon rents to form the great majority of its economic prosperity and to fund its social services. It is, unfortunately, common for nations with similar natural endowments to fail to use these resources to develop their economy fully, at the expense of providing public entitlements in the short term.

An examination of nature of the relative failures of 30 years of economic development planning in Iran would provide valuable insight into the potential of Islamic economic theory as a viable model for an economy. If Iran's development failures result from inherent problems within Islamic economic ideology—tenets and conditions that cannot be reconciled with policies that would expand the diversity, share, and prosperity of the private economic sector—then that insight is valuable for many governments debating the role of Islamic economics in their nations. If, however, the failures are those traditional of rentier states, then not only would Islamic economic theory remain a viable alternative for some, it would also highlight the inadequacies of the Iranian regime's implementation of a fully Islamic state.

¹ CIA World Fact Book estimate, 1 January 2010.

C. PROBLEMS AND HYPOTHESIS

Often a point of contention with regard to Islamic economics is whether it is capable of integrating with the traditional, secular, model of international economics. Detractors believe that Islamic economic theory is not comprehensive or sophisticated enough to be anything more than a niche in international economic systems. The prohibition with dealing in certain financial and economic activities—such as the receipt or paying of interest or dealing with pork products—due to their *haram* (forbidden) status in the *Qur'an* and sayings of the Prophet (*Hadith*) is further evidence, critics say, of the incompatibility of Islamic economics with a modern economy.

While an extensive amount of literature exists regarding economics and development in Iran under the Shah, that volume of research dedicated to the economic development practices under the Islamic Republic lessens throughout time. Today the literature regarding the contemporary economic structure is smaller, and much of it is focused on the political aspects of the economy: penetration of the Iranian Revolutionary Guard Corps (IRGC) into the private sector and the economic effects of international sanctions on the Iranian economy are popular topics for study.

There is little specific analysis of the ideological underpinnings of the regime's economic behavior. As an Islamic state, Iran is theoretically bound by the tenets of Islamic economic and finance theory. Preliminary research shows that economic development is no better (and is, in some respects, much worse) than it was under the Shah's regime. Some opponents to the theological regime believe that there are inherent constrictions on broad economic development inherent to an adherence to Islamic economic theory. Could Iran be an example of this?

Again, preliminary research indicates that the fault for Iran's poor economic development over the years has less to do with any failure of Islamic economic theory, but arises from familiar failings of other hydrocarbon rentier states. The ideology of the Islamic revolution gave the Iranian regime a political screen with which to continue

failed policies of poor central economic planning, over-involvement of the government in the private sector, and misuse of the investment opportunity provided by hydrocarbon windfall revenue.

This thesis will fill the void in analysis of the Islamic philosophical economic ideology in Iran and the role it has (or has not) played in developing the economy. Iran today faces many of the challenges present across the spectrum of Middle East nations—a demographic explosion, public entitlements that claim exorbitant shares of government revenue, poor private sector development, lack of infrastructure investment, and an over-reliance on oil and gas rents. This thesis will examine these failings in light of the government’s stated ideology to reveal that, in fact, Iran’s economic failures are not unique, and are unrelated to any inherent problem in Islamic economic theory.

D. LITERATURE REVIEW

There is relatively little widely-read academic literature that addresses the specific application of Islamic economic theory in Iran and its relative impacts on macroeconomic performance—that is one of the main reasons for this thesis. As a consequence, this thesis will examine two broader areas of study and analysis: Islamic economic theory and Iranian economic analysis. After investigating the issues present in these two areas of research, this thesis will then use this knowledge to formulate independent conclusions regarding the effects of Islamic economic theory in Iran and further examine the root causes of Iran’s economic underperformance.

Regarding the first area of study, Islamic economic theory, one must be aware that there are two distinct foci in the field. The first is the historical foundations (which are relatively recent) and the theoretical paradigms of the ideology itself. The second area concentrates on the determination of whether the differences between Islamic and what we will call “standard” capitalist economics are more than superficial, and if the Islamic economic system is complete enough to support an entire economy.

The driving force behind the modern development of a unique system labeled “Islamic finance” was the wealth created by the oil boom of the early and mid-1970s.² This boom created large amounts of capital in the Middle East (and, more specifically, the Gulf) that also coincided with an increase in Islamic fundamentalism throughout the region. Consequently, there was a desire on the part of Muslims that the rewards of the natural gifts, that in their view Allah has favored their lands, should be handled in accordance with traditional Islamic views on money dictated in *shari’a*.

The notion most generally associated with Islamic economics is the issue of the prohibition of interest. But, in reality, “the main juritic issues... [are] *Riba* and interest, gambling and speculation, transactions involving *gharar* (chance and uncertainty), forward sales, foreign exchange transactions and transactions in debt.”³ The specific text of the *Qur’an* that prohibits *riba*, mostly defined as usury, is exemplified in *Al-Baqarah: 130*, “O ye who believe, do not consume *riba* with continued redoubling and protect yourselves from God, perchance you may be blissful.”⁴ Superficially interpreting the text poses a problem: *riba*, in the pre-Islamic period, was a specific type of interest, where the amount the borrower owed doubled if he was late repaying, and if he was late again, it redoubled.⁵ Some people view *riba* as the prohibition of a specific type, rather than an outright ban on all interest. That, however, is not the prevailing view among the scholars and theologians in contemporary Islam.

The majority of influential Islamic authorities hold that all interest is usury and thus illegal under *shari’a*. Iqbal and Mirakhor summarize thusly:

Riba technically refers to the “premium” that must be paid by the borrower to the lender along with the principle amount as a condition of the loan or for an extension in the duration of the loan. At least four

² Timur Kuran, *Islam and Mammon, the Economic Predicaments of Islamism* (Princeton, NJ: Princeton University Press, 2004), xiii.

³ Muhammad Nejatullah Siddiqi, *Issues in Islamic Banking* (Leicester, UK: The Islamic Foundation, 2004), 15.

⁴ Saiful Azhar Rosely, *Critical Issues on Islamic Banking and Financial Markets* (Bloomington, IN: Authorhouse, 2005), 34. Zamir Iqbal and Abbas Mirakhor, *An Introduction to Islamic Finance; Theory and Practice* (Singapore: John Wiley and Sons, 2007), 58, also list the *Qur’anic* verses 3:130, 2:275–81, 3:130–2, 4:161 and 30:39 as substantiating the prohibition against all interest.

⁵ Rosely, *Critical Issues*, 34.

characteristics define the prohibited interest rate: (1) it is positive and fixed *ex-ante* [before the event]; (2) it is tied to the time period and the amount of the loan; (3) its payment is guaranteed regardless of the outcome of the purposes for which the principle was borrowed; and (4) the state apparatus sanctions and enforces its collection.⁶

The interpretation that all interest is prohibited is substantiated in the core values of Islam, namely justice and equity.⁷ *Riba* was a source of much civic strife in the pre-Islamic period on the Arabian Peninsula. Egregious usury often led to slavery when the debtor could not pay back the ever-increasing loan. Similarly, it seemed inequitable that only one party should be held at risk if the venture for which the loan was made was unsuccessful. Thus, *riba* is viewed as the rich taking advantage of the poor and *Qur'anic* verses prohibiting *riba* are often followed with admonitions toward charity.⁸

Surprisingly, the concept of a unique Islamic economic system was not a subject that concerned early Muslim thinkers, even during the heyday of medieval Islamic philosophy.⁹ Rather, it is a recent invention that has a more than coincidental theological similarity with the broader Islamist movement. As Western colonialism in the late 19th century (C.E.) brought its own style of finance, stirrings of discontent occurred. A point of contention emerged with regard to the idea of interest, specifically when Barclay's Bank established an operation in Egypt.¹⁰ Similar critiques materialized in the late 19th and early 20th centuries (C.E.) within Muslim populations in the Indian sub-continent. But it took the rise of Islamism, and the desire for a wholly Islamic society, to create a financial architecture that could support the intellectual argument for an Islamic state.

The idea of an economic system unique to Islam was born in the mid-20th century (C.E.) by one of the founders of the modern Islamist movement, Sayyid Abul-Ala

⁶ Iqbal and Mirakhor, *An Introduction to Islamic Finance*, 56.

⁷ Rosley, *Critical Issues*, 33.

⁸ Kuran, *Islam and Mammon*, 14.

⁹ Kuran, *Islam and Mammon*, 2.

¹⁰ Iqbal and Mirakhor, *An Introduction to Islamic Finance*, 23.

Mawdudi.¹¹ Mawdudi, founder of *Jama'at-i Islami* in India and Pakistan, became convinced that the only path to a better life for all Muslims was to embrace Islam as the model for personal and societal life. Unlike other early Islamists, Mawdudi had a more thoroughly cogitated idea of the ultimate state of a true Islamic society.¹² As Kimur states, “for Mawdudi Islamic economics was primarily a vehicle for reasserting the primacy of Islam and secondarily an instrument for radical economic change.”¹³ This prioritization of the roles of Islamic economics is the same in many different Islamist movements, such as Ayatollah Ruhollah Khomeini’s comments refuting the idea that the Iranian revolution had an economic motivation. To the Islamist, it is not about the price of watermelons.¹⁴

The motivations that led to the rise of Islamism in general also affected the growth of Islamic economics. As Islamism gained following, so did the idea of Islamic economics. By 1963, the popular desire for a *shari'a*-compliant bank led to the founding of what is generally regarded as the first Islamic bank, the *Mit Ghamr* Local Savings Bank, by Islamic activist Ahmad al-Najjar in Egypt.¹⁵ While the bank itself only lasted four years, it was the vanguard of a larger movement. More banks emerged with the goal of *shari'a* compliance or Islamic values, such as Pilgrims Savings Corporation in 1963 in Malaysia. Their primary goal was to provide Muslims a place to save money for the *hajj* that would be free from the “contamination” of interest found in Western banks.¹⁶ The notion of Islamic banking gathered strength along with broader Islamism. As a tentative rapprochement began between governments and Islamists, so too did the emergence of

¹¹ Iqbal and Mirakhor, *An Introduction to Islamic Finance*, 2. Iqbal and Mirakhor also credit Mawdudi, but also include Imam Muhammad Baqir al-Sadr in Iraq, Anwar Iqbal Qureshi in Pakistan, Mohammad Nejatullah Siddiqi in India, Muhammad Uzair and Umer Chapra in Saudi Arabia, and Ahmad al-Najjar in Egypt as early intellectuals who realized the need for a unique economic system. But most scholars point to Mawdudi as the earliest and most articulate presentation.

¹² Seyyed Vali Reza Nasr, “Mawdudi and the Jama'at-i Islami: The Origins, Theory and Practice of Islamic Revivalism,” in *Pioneers of Islamic Revival*, ed. Ali Rahnama (London, UK: Zed Books Ltd., 1994), 101.

¹³ Kuran, *Islam and Mammon*, 5.

¹⁴ Kuran, *Islam and Mammon*, 6.

¹⁵ Iqbal and Mirakhor, *Introduction to Islamic Finance*, 24.

¹⁶ Iqbal and Mirakhor, *Introduction to Islamic Finance*, 24.

state sponsorship of Islamic banking. The Nasir Social Bank, established in 1971 in Egypt by a Presidential decree, is the first example of a totally interest-free banking institution.¹⁷

The earliest examples of Islamic banking with real economic significance occurred in the mid-1970s, following the first great oil boom, as private Islamic banking emerged. Starting in 1975, with the Dubai Islamic Bank, many more institutions followed to provide a *shari'a*-compliant home for the growing amount of petro-dollars held by Muslims in the Middle East. Then, in 1976, the First International Conference on Islamic Economics took place in Mecca, Saudi Arabia.¹⁸ These steps were mostly unnoticed until the 1980s, when Islamic economics became “mainstream” and the Islamic Republics of Iran, Pakistan and Sudan announced their intentions to transform their entire financial systems to make them *shari'a*-compliant.¹⁹ Historically, Islamic economics and Islamic banking has grown and expanded in popularity in conjunction with the cycles of the oil market. The oil boom times have seen the sector’s expansion as an influx of liquidity into the Middle East permits Muslims the economic freedom to venture into new realms of banking and finance.

Regarding the second broad area of literature necessary for this thesis, Iran provides an excellent case study of Islamic economic ideology as it is one of a scant few nations in the world that purport to be, not just an Islamic political system, but to have all aspects of the social, political, and economic sectors in full adherence to Islamic philosophy.

Central economic planning was the method favored by the Iranian government for 30 years before the revolution and originated in the wake of the systems developed in the Soviet Union, China, and India. Unlike these countries, Iran’s was not a comprehensive input-output based plan; rather, it issued expressions of official intent with regard to the distribution of oil-export revenue among public investment projects.²⁰ At the time, Iran’s

¹⁷ Iqbal and Mirakhor, *Introduction to Islamic Finance*, 24.

¹⁸ Iqbal and Mirakhor, *Introduction to Islamic Finance*, 24–25.

¹⁹ Iqbal and Mirakhor, *Introduction to Islamic Finance*, 25.

²⁰ Jahangir Amuzegar, “Iran’s Post–Revolutionary Planning: The Second Try,” *Middle East Policy* III:1, (March 2001): 25–26.

“technocratic” approach to economic development (increasing output by encouraging either the adoption of improved technology or by increasing greater incorporation of conventional inputs, such as capital) seemed in line with the country’s stated “liberal capitalist ideology.”²¹

In the immediate aftermath of the revolution, the idea of central economic planning was maintained largely because of the influence, at the time, of Islamist Marxists and “left-leaning populist clergy.”²² To complicate the process, however, the Khomeini regime also added social and cultural aspects to the existing economic planning process. Khomeini’s notions of *velat-i faqih* (sovereignty of the jurist) meant that he, and the Supreme Leaders who would follow him, must have governance over all aspects—cultural, religious, social, and economic—of the *umma*. Thus, the ideas of economic development are subordinated to the interests of the social development of the state. This made what had been a difficult task under the Shah’s anemic administrative capacity nearly impossible in the post-revolution Islamic state.

Further complicating the task of developing the Iranian economy after the 1979 revolution was the war with Iraq that began in 1980 and consumed a majority of the military, political, social, and economic resources of the country for the following decade. The Iran-Iraq War prevented the type of centralized economic planning that had characterized the Pahlavi state.²³ Two reasons for this likely exist. The first, and most obvious, reason is that the war was an economic catastrophe for Iran. The effects of the war on the Iranian economy will be examined in greater detail subsequently, but for now it is sufficient to say that the constant and severe tax on Iran’s resources of blood and treasure limited it to ad hoc economic policy rather than well thought out development strategy.

²¹ Robert E. Looney, *Economic Origins of the Iranian Revolution* (New York: Pergamon Policy Studies Press, 1982): 258.

²² Jahangir Amuzegar, “Iran’s Post–Revolutionary Planning,” 26.

²³ Anonymous, “Iran.” *Oxford Economic Country Briefings: Iran* (19 August 2009): 1–5. <http://www.proquest.com/> (accessed 9 March 2010)

The second reason for the hiatus of central economic planning was its lack of appeal to Ayatollah Khomeini, the Islamic Revolution's literal and spiritual leader. The man unconcerned with the price of watermelons was similarly unconcerned with the economic factors affecting the price of the watermelon in the first place. Evidence supporting this is found in the elevation of economic issues to a place of primacy in the regimes that followed Khomeini.²⁴ This was a subtle, though tacit, rebuke of that part of the Supreme Leader's guidance. Sound economic planning, however, took a seat behind political ideology with the arrival of the Iran-Iraq war, which followed soon after the Islamic Revolution.

It is difficult to emphasize the severity and rapidity with which the Iran-Iraq war wrecked the Iranian economy. By the end of 1981, foreign exchange reserves fell from \$14.6 billion at the end of the Pahlavi regime, to \$1 billion at the close of 1981. While the government initially relied on oil production to sustain the economy, the increases of 1982 and '83 (to \$19 billion from \$12 billion in 1981) were not sustainable. By 1984 and '85, revenues were back at \$12–13 billion and continued to fall (\$6.6 billion in 1986). The consequential 50% unemployment by 1987 resulted in the government creating schemes to mobilize labor (specifically in the agricultural sector) by exempting members of "The Reconstruction Campaign" from military service and sending them instead to rural areas. Additionally, the government sought to ration precious foreign currency by limiting imports of "non-essential" products.²⁵

Following the conclusion of the Iran-Iraq war, the imminent need to restore the nation to a functioning economic foundation was obvious. Precipitous to this was the death of Khomeini in 1989, which allowed more economically progressive personalities to influence the country's policies. It is from this point that the Iranian government is most able to exert independent control of the economy, guided by the economic principles of their choosing.

²⁴Jahangir Amuzegar, "Iran's Post-Revolutionary Planning," 26.

²⁵Efraim Karsh, *The Iran-Iraq War: 1980–1988* (New York: Osprey Publishing, Ltd., 2002): 74–75.

E. METHODS AND SOURCES

To adequately understand the theological basis and modern economic instruments of Islamic economics, this paper will use a broad range of sources including scholarly books and journal articles, information from organizations involved in the global financial system (such as the World Bank and International Monetary Fund), contemporary news publications centered on politics and economics (such as *The Economist* and *Financial Times*) and, critically, financial data directly obtained from the significant actors in global Islamic finance (such as Islamic banking arms of the major banks, such as HSBC).

This paper will be a case study on the Iranian economy and will use historical narrative based on macroeconomic data to examine the economic development plans of the various Iranian administrations and assess the actual role of Islamic economic thought in those plans. Economic development data will come from the Iranian government, international economic institutions (World Bank, IMF, WTO), and economic publications, as well as scholarly work, on economic development in general and Iran in particular. To enable this, this paper will analyze the costs and benefits of Iranian economic development schemes and identify economic development theories used by the Iranian government. Further, this paper will assess the overall effectiveness of the applied development theories and identify which factors contributed to (or hindered) this effectiveness. By doing so, this paper will highlight the role of politics and religion within the Iranian economic system and identify barriers to further economic development.

F. THESIS OVERVIEW

This thesis will be organized into five chapters, representing an introduction chapter, three analytic/research chapters, and conclusion chapter. An overview of chapter organization is as follows:

Chapter I provides an introduction to the topic, states the research question addressed, its overall importance to the field of study, the methods and sources employed, and a review of the relevant literature on the topic.

Chapter II investigates Islamic economic theory, its historical origins, the general principles by which it is used in a modern economic system, and points of potential conflict or difficulty that arise in comparison with “Western” secular capitalism.

Chapter III examines the economy of Iran following the revolution against the Shah and replacement by the Islamic Republic. Specifically, this chapter looks at the economic and other relevant (and unique) aspects of the Islamic Republic’s ideology, as articulated by its founder, Ayatollah Ruhollah Khomeini, and as successive leaders have implemented that religious economic ideology.

Chapter IV uses the foundations established in Chapters II and III to analyze specific macroeconomic programs in Iran and the associated economic performance in the first 30 years of the Islamic Republic. This chapter identifies the key elements of Islamic economic theory purportedly used in Iranian macroeconomic policy, and determines if they have, in fact, been implemented in practice. Further, Chapter IV analyzes the structural and political/policy factors responsible for Iran’s economic successes and failures.

Chapter V is the conclusion, detailing succinctly the findings of this thesis and highlighting policy implications and issues for further research.

II. “WESTERN” AND ISLAMIC ECONOMIC THEORY

A. ECONOMIC DEVELOPMENT THEORY

To understand the specific performance of the post-revolution Iranian economy and highlight the selection and execution of economic development of Iran’s economy, one must understand the basic theory of economic development as it is defined in the Western capitalist model and be able to compare this to Islamic economic theory. Through this, one can create an appreciable measure of Iran’s economic successes and failures. That is, Iran’s economic conditions must be appraised by the intended and unintended consequences of the government’s economic planning and execution under its own philosophical tenets. In other words, one must measure Iran’s economic successes, failures, and methods against goals and methods that are philosophically compatible with Islam.

In general “economic development,” as it is understood in Western capitalist systems, is also transferable to Islamic systems as well. The overall goal of an expansive and diverse private-sector economy operating within a legal framework provided by limited governmental regulation is common to both paradigms. The distinction between simple growth of the economy—that is, the overall increase in the size of the economy as measured by increasing GDP over time—and economic development is important in assessing a country’s economic health. If economic development is to be understood as distinct from economic growth, then it is clear that Iran has been largely unsuccessful with regard to development. To define development, this paper will use Perkins, Radelet and Lindauer:

Economic development implies more, particularly improvements in health, education, and other aspects of human welfare.... If all of the increased income is concentrated in the hands of a few rich elite or spent on monuments or military apparatus, there has been very little development...²⁶

²⁶ Dwight H. Perkins, Steven Radelet, and David L. Lindauer, *Economics of Development*, 6th Ed. (New York: W.W. Norton & Company, 2006): 12.

Thus, it is not simple expansion of GDP that we understand as development but a range of improvements to the industrial, economic, and social structure of the nation. As the Michael Spence's 2007 report indicates, economic growth should be an agent of economic development in order to improve a society.²⁷

Additionally, Perkins et al. state three specific reasons why economic development cannot be assumed as a natural outcome of growth. First, they state, economic growth is not shared among the population but instead is concentrated in people and institutions that augment the "power and glory of the state and its rulers." Secondly, consumption increases are delayed (often perpetually) in favor of heavy investment of resources in the present time. Third, rise in GDP does not result in an increase in overall standard of living for the majority, but causes a growth in wealth disparity as the wealthy increase their share of GDP relative to the rest of the population.²⁸

It is clear that, from the beginning, the five-year economic development plans of the Islamic Revolutionary Government accepted the idea that structural reforms were necessary for the country's economic well-being; particularly in the aftermath of the war with Iraq and the loss of domestic industrial production. While figuratively a centrally planned economy, the First Development Plan set the themes of market-oriented structural reforms focusing on expanding privatization of the economy, reducing the direct participatory role of the government, deregulation and liberalization that are found in all subsequent plans.²⁹ These themes were appropriate for Iran's economic situation following the war with Iraq, and these structural reforms were successful to the extent they were implemented. This success was only relative, however, since the economy grew and developed in comparison with the abysmal showing during the eight years of war, but failed to establish long-lasting reforms to the structure.

²⁷ Michael Spence, "The Growth Report: Principle Findings and Recommendations," *Spence Commission on Growth and Development* (London, May 2008).

²⁸ Perkins et. al., *Economics of Development*, 39–40.

²⁹ Amuzegar, "Iran's Post-Revolutionary Planning," 26.

B. THE ORIGINS OF ISLAMIC ECONOMICS

The notion most generally associated with Islamic economics is the issue of the prohibition of interest. But in reality, “the main juritic issues... [are] *Riba* and interest, gambling and speculation, transactions involving *gharar* (chance and uncertainty), forward sales, foreign exchange transactions and transactions in debt.”³⁰ The specific text of the *Qur'an* prohibits *riba* mostly defined as usury, in *Al-Baqarah: 130*, “O ye who believe, do not consume *riba* with continued redoubling and protect yourselves from God, perchance you may be blissful.”³¹ Superficially interpreting the text poses a problem: *riba*, in the pre-Islamic period, was a specific type of interest, where the amount the borrower owed doubled if he was late repaying, and if he was late again, it redoubled.³² Some people view *riba* as the prohibition of a specific type, rather than an outright ban on all interest. That, however, is not the prevailing view among the scholars and theologians in contemporary Islam.

The majority of influential Islamic authorities hold that all interest is usury and thus illegal under *shari'a*. Iqbal and Mirakhor summarize thusly:

Riba technically refers to the “premium” that must be paid by the borrower to the lender along with the principle amount as a condition of the loan or for an extension in the duration of the loan. At least four characteristics define the prohibited interest rate: (1) it is positive and fixed *ex-ante* [before the event]; (2) it is tied to the time period and the amount of the loan; (3) its payment is guaranteed regardless of the outcome of the purposes for which the principle was borrowed; and (4) the state apparatus sanctions and enforces its collection.³³

The interpretation that all interest is prohibited is substantiated in the core values of Islam, namely justice and equity.³⁴ *Riba* was a source of much civic strife in the pre-

³⁰ Siddiqi, *Issues in Islamic Banking*, 15.

³¹ Rosely, *Critical*, 34. Iqbal and Mirakhor, *An Introduction to Islamic Finance*, 58, also list the *Qur'anic* verses 3:130, 2:275–81, 3:130–2, 4:161 and 30:39 as substantiating the prohibition against all interest.

³² Rosely, *Critical Issues*, 34.

³³ Iqbal and Mirakhor, *An Introduction to Islamic Finance*, 56.

³⁴ Rosley, *Critical Issues*, 33.

Islamic period on the Arabian Peninsula. Egregious usury often led to slavery when the debtor could not pay back the ever-increasing loan. Similarly, it seemed inequitable that only one party should be held at risk if the venture for which the loan was made was unsuccessful. Thus, *riba* is viewed as the rich taking advantage of the poor and *Qur'anic* verses prohibiting *riba* are often followed with admonitions toward charity.³⁵

Surprisingly, the concept of a unique Islamic economic system was not a subject that concerned early Muslim thinkers, even during the heyday of medieval Islamic philosophy.³⁶ Rather it is a recent invention that has more than a coincidental theological similarity with the broader Islamist movement. As Western colonialism in the late 19th century (C.E.) brought its own style of finance, stirrings of discontent occurred. A point of contention emerged with regard to the idea of interest, specifically when Barclay's Bank established an operation in Egypt.³⁷ Similar critiques materialized in the late 19th and early 20th centuries (C.E.) within Muslim populations in the Indian sub-continent. But it took the rise of Islamism, and the desire for a wholly Islamic society, to create a financial architecture that could support the intellectual argument for an Islamic state.

The idea of an economic system unique to Islam was born in the mid-20th century (C.E.) by one of the founders of the modern Islamist movement, Sayyid Abul-Ala Mawdudi.³⁸ Mawdudi, founder of *Jama'at-i Islami* in India and Pakistan, became convinced that the only path to a better life for all Muslims was to embrace Islam as the model for personal and societal life. Unlike other early Islamists, Mawdudi had a more thoroughly cogitated idea of the ultimate state of a true Islamic society.³⁹ As Kimur states, "for Mawdudi Islamic economics was primarily a vehicle for reasserting the

³⁵ Kuran, *Islam and Mammon*, 14.

³⁶ Kuran, *Islam and Mammon*, 2.

³⁷ Iqbal and Mirakhor, *An Introduction to Islamic Finance*, 23.

³⁸ Ibid. 2. Iqbal and Mirakhor also credit Mawdudi, but also include Imam Muhammad Baqir al-Sadr in Iraq, Anwar Iqbal Qureshi in Pakistan, Mohammad Nejatullah Siddiqi in India, Muhammad Uzair and Umer Chapra in Saudi Arabia, and Ahmad al-Najjar in Egypt as early intellectuals who realized the need for a unique economic system. But most scholars point to Mawdudi as the earliest and most articulate presentation.

³⁹ Seyyed Vali Reza Nasr, "Mawdudi and the Jama'at-i Islami: The Origins, Theory and Practice of Islamic Revivalism." 101.

primacy of Islam and secondarily an instrument for radical economic change.”⁴⁰ This prioritization of the roles of Islamic economics is the same in many different Islamist movements, such as Ayatollah Ruhollah Khomeini’s comments refuting the idea that the Iranian revolution had an economic motivation. To the Islamist, it is not about the price of watermelons.⁴¹

The motivations that led to the rise of Islamism in general also affected the growth of Islamic economics. As Islamism gained following, so did the idea of Islamic economics. By 1963, the popular desire for a *shari’a*-compliant bank led to the founding of what is generally regarded as the first Islamic bank: the *Mit Ghamr* Local Savings Bank by Islamic activist Ahmad al-Najjar in Egypt.⁴² While the bank itself only lasted four years, it was the vanguard of a larger movement. More banks emerged with the goal of *shari’a* compliance or Islamic values, such as Pilgrims Savings Corporation in 1963 in Malaysia. Their primary goal was to provide Muslims a place to save money for the *hajj* that would be free from the “contamination” of interest found in Western banks.⁴³ The notion of Islamic banking gathered strength along with broader Islamism. As a tentative rapprochement began between governments and Islamists, so too did the emergence of state sponsorship of Islamic banking. The Nasir Social Bank, established in 1971 in Egypt by a Presidential decree, is the first example of a totally interest-free banking institution.⁴⁴

The earliest examples of Islamic banking with real economic significance occurred in the mid-1970s, following the first great oil boom, as private Islamic banking emerged. Starting with the Dubai Islamic Bank in 1975, many more institutions followed to provide a *shari’a*-compliant home for the growing amount of petro-dollars held by Muslims in the Middle East. Then, in 1976, the First International Conference on Islamic

⁴⁰ Kuran, *Islam and Mammon*, 5.

⁴¹ Kuran, *Islam and Mammon*, 6.

⁴² Iqbal and Mirakhor, *Introduction to Islamic Finance*, 24.

⁴³ Iqbal and Mirakhor, *Introduction to Islamic Finance*, 24.

⁴⁴ Iqbal and Mirakhor, *Introduction to Islamic Finance*, 24.

Economics took place in Mecca, Saudi Arabia.⁴⁵ These steps were mostly unnoticed until the 1980s, when Islamic economics became “mainstream” and the Islamic Republics of Iran, Pakistan and Sudan announced their intentions to transform their entire financial systems to make them *shari’a* compliant.⁴⁶ Historically, Islamic economics and Islamic banking has grown and expanded in popularity in conjunction with the cycles of the oil market. The oil boom times have seen the sector’s expansion as an influx of liquidity into the Middle East permits Muslims the economic freedom to venture into new realms of banking and finance.

Today, the global consequences of the “Great Recession” have brought Islamic economics to the fore as a potential competitor to traditional Western capitalism. Up through the early fall of 2009, it appeared that the Islamic Financial sector had not only escaped the worst of the global financial crisis, but had performed reasonably well. Helping this was the fact that the industry has almost no exposure to the sub-prime loan industry (as the mechanisms of constructing *shari’a*-compliant home loans are difficult).⁴⁷ The biggest impact to Islamic finance thus far has been a loss of liquidity flowing into the region as Western sources of cash have dried up. Islamic banks also were not as highly leveraged as Western banks, so they had more ability to absorb losses without having to resort to government assistance.⁴⁸ While the effect to the industry as a whole has not been as dramatic, certain segments, specifically *sukuk* (Islamic bonds), have very recently encountered trouble.

All *sukuk* saw a dramatic reduction in investment in 2008–2009. Issues of *sukuk* in 2008, globally, fell by more than half of 2007 amounts (to approximately \$20 billion).⁴⁹ This is a natural outcome of the global situation as investors are less likely to invest in debt issues in uncertain financial times due to the risk of loss. The outlook for the *sukuk* industry potentially changed on November 25, 2009, when, late in the day

⁴⁵ Iqbal and Mirakhor, *Introduction to Islamic Finance*, 24–25.

⁴⁶ Iqbal and Mirakhor, *Introduction to Islamic Finance*, 25.

⁴⁷ Andrew Wood, “Islamic finance escapes worst of the crisis,” *Financial Times* (7 June 2009).

⁴⁸ Wood, “Islamic finance.”

⁴⁹ Wood, “Islamic finance.”

before the *Eid al-Adha* holiday, Dubai World announced its intentions to suspend payments of \$59 billion worth of debt for at least 6 months. This includes a \$3.5 billion *sukuk* that was due for payment December 14 of 2009.⁵⁰

C. ISLAMIC ECONOMICS AND FINANCE: CURRENT PRACTICES AND ISSUES

1. The Public Sector: Financing the Government

Islamic economics presents unique challenges, both for public and private sector finance. The most significant concern in designing a *shari'a*-compliant financial system is the issue of interest. Specifically, the idea of risk-free investment with a rate of return determined *ex-ante* is problematic because this is how both governments and banks function in the modern, globalized world.⁵¹ *Shari'a* prohibits a government's conventionally issued bond, for example, as it predetermines the rate of return and that return is guaranteed. Even when bonds are raised for a specific purpose (e.g., the city of Los Angeles wants to issue a bond to build a bridge), there is no linkage between the performance of the activity the bond was created to fund, and its potential return. The bond is guaranteed, and the borrower assumes all the risk; this is fundamentally counter to Islamic notions of fairness and equity. Similarly, private sector banking also faces issues with inherent noncompliance with *shari'a*. Modern, or "Western," banking relies heavily on both the issuance and receipt of interest.

The public sector solutions generally conceived involve the bifurcation of government projects into two classes: asset creating and non-asset creating.⁵² Those projects that are asset creating could conceivably be financed through traditional market economics, where the government would, like a business, issue a call for investment in a particular project. Those choosing to participate would be able to purchase an equity

⁵⁰ Roula Khalaf, Simon Kerr, and Andrew England, "Stopped in its tracks," *Financial Times—Analysis* (2 December 2009).

⁵¹ Nadeem Ul Haq and Abbas Mirakhor, "The Design of Instruments for Government Finance in an Islamic Economy" (IMF Research Paper WP/98/54, 1998): 3.

⁵² Ul-Haq and Mirakhor, "Government Finance," 4–5.

stake (a share of the project, but not guaranteed return) that would either return a profit or a loss. Essentially, this is like owning stock in a company: one owns an equity share in the company at a price the market determines based on known factors contributing to its value. At the end of the year the company, providing it has done well, generates enough profit to cover its expenses and distributes the excess to its shareholders via dividends. If the company underperforms, they payout no dividends, the price of the stock falls and the investor loses money. In an equity investment, there is no guaranteed return. Therefore, in the earlier example where Los Angeles wants to build a bridge, the city would seek investors in the project, who would purchase a share in the actual construction of the bridge. To be an asset, the bridge would have to have more than intrinsic value, and a likely scenario would see a toll collected. The profitability of the bridge would then be easily determined.

Non-asset generating government projects, however, require a different method of finance. By definition, one cannot sell equity in something that is not an asset (as it has no real or, at least, easily quantifiable value); one example would be defense procurement. Defense is a classic area that is solely consumptive (in asset terms), not productive. While a nation arguably reaps some collective good from the expenditure, and old and obsolete defense equipment gets sold off to foreign nations occasionally, this does not change the fact that defense equipment costs money that is never recouped in kind. In a nation that is operating fully on an Islamic economic (*shari'a-compliant*) model, the only way for the state to pay for non-asset creating endeavors is through taxation.⁵³ This creates secondary issues: the *Qur'an* stipulates the taxation rate of Muslims in an Islamic state (*zakat*). *Zakat* has several unique factors, especially with regard to government finances. First, *zakat* are “levied and calculated on actual taxable items... in-kind taxes.” The taxes may be paid, however, in in-kind or equivalent value.⁵⁴ Therefore, a farmer could conceivably pay his taxes in corn, if that was his product. Complicating matters is the fact that the taxation rate is calculated *by specific*

⁵³ Ul-Haq and Mirakhor, “Government Finance,” 4–6.

⁵⁴ Ali Reza Jalili, “A Descriptive Overview of Islamic Taxation,” *Journal of American Academy of Business*, Cambridge (March 2006): 19.

item, not merely categorically. For example, there is a tax on lentils but not apricots.⁵⁵ Further complication to the taxation issue includes *shari'a* restrictions and compulsions on what taxes from the public treasury may be spent on. The implications of the ideas of *zakat* and equity financing of public projects are that a fully Islamic government economic system would finance a true “public sector.”

The complexity and potential issues of enforcement are likely reasons why there are few fully Islamic economies in any nation. While some, such as the Islamic Republics of Iran and Pakistan, have stated their desire and intentions to transition to fully *shari'a*-compliant public financial sectors, none of their systems hold up as fully compliant under independent scrutiny. Iran, for example, has issued a ruling that fixed-rate interest charging between government institutions is permissible (presumably because no “individuals” are involved, and consequently no individual could be harmed by *riba*).⁵⁶ Not only does this illustrate the difficulties of operating a modern nation-state under Islamic economics, it also highlights the most significant point of contention for critics of the system: that Islamic economics manages most of the issues of *shari'a* prohibited practices by renaming them. This will be discussed more thoroughly in the following section on private sector finance.

2. The Private Sector: Islamic Finance

Private sector finance also faces challenges under an Islamic economic system; once again, the point of contention is *riba*. It would seem intuitively impossible for a bank to function under rules prohibiting the very method by which banks make a substantial portion of their income. The rapid growth of worldwide Islamic banking, however, would seem to prove this assumption incorrect. In 2009, the Islamic banking industry possessed *shari'a*-compliant assets valued at over \$822 billion, a 28.6% growth from the previous year. Accordingly, the expectation is for Islamic finance as an industry

⁵⁵ Jalili, “Islamic Taxation,” 19.

⁵⁶ Kuran, *Islam and Mammon*, 15.

to total \$1.03 trillion by 2010.⁵⁷ Indeed, emerging and developing economies have seen the fastest growth in Islamic finance over the past few years while an increasing number of banks in developed countries have opened Islamic “windows.”⁵⁸

A window, in financial terms, is a part of the bank that, while created from the greater corporation, is wholly self-contained. This is important when it comes to issues such as *shari’a* compliance. HSBC Amanah, for example, the Islamic banking window for the Hong Kong Shanghai Banking Corporation (British by tradition, and one of the world’s largest banks) maintains that its connections to HSBC are tenuous enough that its board of *shari’a* scholars has declared HSBC Amanah to be untainted by the *riba* of the original company. Through both established and emerging Islamic banks, *shari’a*-compliant financing has grown rapidly in recent years and currently possesses significant financial credibility. This success has been achieved, however, more through creative interpretations of standard banking practices than it has from a truly unique economic philosophy.

Finance is the investment and return of money and comes in several variations. As stated in the earlier section on how Islamic economics impacts government financing, in the private sector, there are generally two (very basic) ways of making money through finance. One is the purchase of an equity share (like stock; one owns an actual portion of the company and the company invests the money in increasing production, but returns a dividend only if there is profit). The other is the purchase of a bond (basically a loan to a company, individual, or government, where risk is theoretically minimal and return on investment is guaranteed at a predetermined rate). In general, Islam has no problem with equity financing if there is no Islamic compunction with the financed issue.⁵⁹ Indeed, this method of financing, with its equal distribution of risk of loss and sharing of profit,

⁵⁷ Financial Times and HSBC Amanah Bank, “The Top 500 Islamic Financial Institutions.” The Banker, November 2009 Supplement, Financial Times Business, Ltd. (London, UK, 2009). Received as advanced copy through personal communications with Corporate Communications Manager, HSBC Amanah, HSBC Bank Middle East Ltd. (4 November 2009): 3.

⁵⁸ Financial Times, “Top 500.”

⁵⁹ Iqbal and Mirakhor, *Introduction to Islamic Finance*, 77.

fits the moral compass of Islam well. Where Islamic financing has had to be creative is in the area of loaning money and getting a return on investment that is *shari'a*-compliant.

There are many diverse and unique methods of Islamic finance, but it is sufficient to concentrate one's understanding on four basic types of finance used to work around the prohibition on *riba*: *mudaraba*, *musharaka*, *murabahah*, and *ijara*.⁶⁰ The first two, *mudaraba* (a trustee financing contract, but also translated simply as a "partnership") and *musharaka* (equity partnership), are profit and loss sharing arrangements that have been known since the beginning in Islam and have roots in classical Islamic jurisprudence.⁶¹ *Murabahah* (cost-plus sales) and *ijara* (lease purchase) are more recent financing models. In fact, *murabahah* is the most popular financing model for Islamic banks.⁶² The following paragraphs will detail how these financial instruments work, and also reveal that they are generally recognizable to anyone familiar with some of the basics of "Western" finance.

In financial terms, *mudabara* is when an investor, or group (i.e., a bank) "entrusts" capital to a person, usually for the purposes of starting or enhancing a business. The recipient, or trustee, of the money then puts it into production or trade and "returns... a prespecified share of the resulting profits along with the principle."⁶³ What profit is left is retained by the trustee as reward for time and labor. What is critical in this relationship is the fact that the risk is borne by both parties; should the business fail, the "investor" will lose his principle and the trustee loses his labor. This notion of shared risk is integral to Islam writ large, and Islamic economic theory specifically. *Musharaka* is similar to *mudabara*, but with the distinction that the trustee adds some of his own capital to the venture. This capital stands either to be lost or returned to the trustee, depending on the

⁶⁰ Shirley Chiu and Robin Newberger. "Islamic Finance: Meeting Financial Needs with Faith Based Products," *Profitwise News and Views—A Quarterly Magazine of the IMF* (February 2006): 9. Iqbal and Mirakhor, *Introduction to Islamic Finance*, in chapter 3 do perhaps the most comprehensive listing of the various instruments of Islamic finance found in any one publication. The limiting of this paper to the four principle instruments stated is because a) these are the four universally acknowledged methods of Islamic financing found in nearly all discussions on the topic; and b) because the other methods are either variants or modifications of those discussed here.

⁶¹ Kuran, *Islam and Mammon*, 8.

⁶² Kuran, *Islam and Mammon*, 10.

⁶³ Kuran, *Islam and Mammon*, 8.

performance of the company. *Musharaka* combines the ideas of partnership and management, and is used in lieu of debt security, a forbidden concept in Islam.⁶⁴

These concepts of financing are in fact not unique to Islam. Western finance has a similar concept to *mudaraba* and *musharaka* in venture capital. Here, it is important to distinguish the general differences between a venture capitalist and a bank. First, the venture capitalist bases investment decisions on the potential profitability of a specific idea, not the previous credit history of the borrower as a bank would. The venture capitalist is solely concerned with whether the idea is sound and potentially profitable, not what collateral the borrower may have. Second, the venture capitalist takes a share of the profit, whereas a bank gets a guaranteed return in the form of interest. Third, the venture capitalist has a much closer relationship to the investment enterprise, occasionally participating directly in the management of the process; unlike a bank whose relationship is a passive one with its investment.⁶⁵ Understanding these differences is critical to evaluating the *shari'a* compliance of these financial methods.

Murabahahs are designed to replicate conventional loans for the purchase of commodities. The concept can best be explained by example: a bank lends money to an entrepreneur who needs to purchase raw material but lacks capital. The financier and the borrower agree on a “mark-up” (profit margin) added to the cost of the product. The repayment is delayed for a set period of time while the entrepreneur inputs the material into his final product and sells it. Often, to avoid dealing with the hassle of actually taking possession of the commodity before reselling it to the entrepreneur, the bank will appoint the entrepreneur as their agent authorized to accept delivery and hold the merchandise (though the bank is still technically the owner).⁶⁶ It is important to understand that *murabaha* is a contract on a sale, and comes with several restrictions. First, the transaction cannot be for financing purposes, such as working capital, payment

⁶⁴ Iqbal and Mirakhor, *Introduction to Islamic Finance*, 92.

⁶⁵ Kuran, *Islam and Mammon*, 8.

⁶⁶ Iqbal and Mirakhor, *Introduction to Islamic Finance*, 87–89. *Financial Times* also has an excellent presentation by David Oakley, Shannon Bond, Cynthia O’Murchu and Cleve Jones published 30 May 2008 and titled “Explaining Islamic Finance,” that illustrates inter-bank *murabaha*. It can be viewed at: <http://www.ft.com/cms/s/0/5067aace-2e67-11dd-ab55-000077b07658.html>

of wages, settling accounts, etc. The financier must actually purchase a tangible item. Second, should the entrepreneur default (which, in Islamic finance, is non-payment of two consecutive payments), the financier only has legitimate claim to the value of the financed good, not the mark-up or any other price adjustments.⁶⁷ While the mechanics above seem to be very similar to a conventional understanding of interest (the financier, after all, has no actual interest in the commodity and never takes real possession of it), it is critical to the *shari'a* interpretation that it is trade that is being conducted, because there is *Qur'anic* justification for trade and prohibition of *riba*.⁶⁸ As Iqbal and Mirakhor state,

The legal difference between *murabaha* and an interest based loan is clear—whereas the former is a sale contract in which the price is increased for deferment of payment, the latter is an increase in the amount of debt for deferment. The first is permitted but the second is not.⁶⁹

This distinction is also important to understanding with regard to the fourth tool of Islamic finance, *ijara*.

Ijara, or *al-ijara 'ain*, in a sense combines financing and collateral as it is more like a lease, or hire-purchase (called *ijara-wa-iktana*).⁷⁰ Like all forms of Islamic financing, *ijara* is a purchase contract. In this case, however, what is purchased is not a tangible asset, but rather the right to use an object (*usufruct*) for a specified period.⁷¹ This is similar to a conventional lease. Just as when one leases a car, one does not own the car, but is paying for the privilege to drive it for specific period. Where the hire-purchase aspect of *ijara* comes in is when a bank, or other financier, purchases something on behalf of someone and then leases it back for a specific period. Often, the end result is an ownership transfer of the asset at the end of the lease, and the amount paid comes out

⁶⁷ Iqbal and Mirakhor, *Introduction to Islamic Finance*, 90.

⁶⁸ *Qur'an* (2:275) contains the question: “trade is like *riba*...” and the answer: “but Allah has permitted trade and forbidden *riba*.” As quoted in Iqbal and Mirakhor, 90.

⁶⁹ Iqbal and Mirakhor, *Introduction to Islamic Finance*, 90.

⁷⁰ Anonymous, “Doing Business the Islamic Way,” *Financial Times* (29 April 2006).

⁷¹ Chiu and Newberger, “Islamic Finance,” 10. Rosly, *Critical Issues*, 104–105. Iqbal and Mirakhor, *Introduction to Islamic Finance*, 84.

to the cost of item plus profit for the financier.⁷² It is important also to understand that the *ijara* contract is for the utilization of something, not the consumption of it; thus, one condition of *ijara* is that the object cannot be perishable or consumable.⁷³

The last major instrument of the Islamic financial system is the *sukuk*, otherwise known as an Islamic bond. While *sukuk* (the plural of *sakk* in Arabic, meaning certificate) has recognition in traditional Islamic jurisprudence, it is a recent innovation (the first was launched in 2001) and can be more easily understood as a type of proportional ownership over a defined period.⁷⁴ While often ascribed the term “Islamic bond,” it is important to understand *sukuk* differs from the traditional bond definition. A bond usually represents pure debt on the part of the issuer and creates a lender/borrower relationship. Repayment of the bond with any additional money would be akin to *riba*. Instead, *sukuk* represents an ownership stake (like the equity described earlier), for a set period, where a *mudaraba* contract (the trustee financing relationship) is created with a profit-sharing arrangement.⁷⁵ Due to its nature as a form of debt securitization, most *sukuk* are issued either by governments (often through sovereign wealth funds) or government-backed private companies. The recent, and now notorious, example of the default of Dubai World (the government-sponsored private development corporation) on its debt, which included a \$3.5 billion *sukuk*, is an example of how private-issue *sukuks* often have attachment to host-nations.

Until recently, *sukuk* were among the hottest trends in the global financial markets. Their combination of presumed security and Islamic compatibility attracted investors. Between the first recognized launch of a significant *sukuk* in Malaysia in 2001, and the 2007 *sukuk*, investment from the Gulf States alone was valued at over \$40 billion.⁷⁶ The arrival of the “Great Recession,” however, and recent issues of potential

⁷² *Financial Times*, “Doing Business the Islamic Way,” Rosely, *Critical Issues*, 105. Iqbal and Mirakhor, *Introduction to Islamic Finance*, 84–85.

⁷³ Iqbal and Mirakhor, *Introduction to Islamic Finance*, 85.

⁷⁴ *Financial Times* “The Top 500 Islamic Financial Institutions,” 10. Iqbal and Mirakhor, *Introduction to Islamic Finance*, 178.

⁷⁵ Iqbal and Mirakhor, *Introduction to Islamic Finance*, 178.

⁷⁶ *Financial Times*, “The Top 500,” 10.

default and suspension of debt payment by large *sukuk*, such as Dubai World, have tempered investors' enthusiasm for the product. Perhaps the largest contributor to the loss of confidence in *sukuk* by non-Islamic investors has been the question of exactly which laws govern the repayment of the bond. The Dubai World bonds were issued on the London exchange and, as such, are regarded (under British law) as being asset-secured in the same way as conventional bonds (that is, that debt holders have recourse to a company's physical assets as compensation in the event of default). This conflicts with Islamic law in force in Dubai, however, where the company and its assets are headquartered. Had the holders of the Dubai World *sukuk* not agreed to hold off on seeking compensation, the issue of whose law governs the *sukuk* would have been thrust to the fore. For now, it remains an unresolved issue with the potential for problems down the road.

Chapter II has served as primer on the basic issues of Islamic finance and economics. As the following chapters will illustrate, however, Iran has not fully adopted a completely Islamic economic identity. While the public sector, the government, purports to operate under the tenets of Islam, all the private sector mechanisms of Islamic finance found elsewhere in the Muslim world are not as thoroughly present in Iran. The range of potential private sector financial products described here are lacking in Iran, and the private economy's Islamic concerns are mostly limited to ensuring that the private sector is not involved in profiting from prohibited items. Understanding the full potential of the public and private sectors of an Islamic financial system is key to recognizing the dearth of Islamic financial options in Iran's private industry. The government's virtual monopoly of the major sources of industry and economic production has limited the role of influence of Islamic private sector financial activities.

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III. IRANIAN IDEOLOGY: THE ROLE OF ISLAM, GOVERNMENT, AND ECONOMICS

A. FOUNDATIONS OF CONTEMPORARY ECONOMIC POLICY IN IRAN

1. Centralized Planning: The Sole Survivor of the Pahlavi State

Ayatollah Ruhollah Khomeini once famously stated that the Iranian Islamic Revolution was not about “lowering the price of watermelons.”⁷⁷ The Iranian Islamic Revolution sought to overturn many of the legacy social and government institutions of the Pahlavi state. One legacy that was retained, however, was the economic central planning of the government. Due to the influence of Marxists and other left-leaning Islamists in the Iranian Revolution in 1979, centralized economic planning continues to be the primary method of influencing economic development within the country. This central planning ultimately has been unsuccessful in drastically changing the Iranian economy from the days of the Shah. Indeed, the combination of religious and political influences on what were potentially sound economic development plans resulted in a narrowing of the overall economy and has had no effect in reducing the deleterious role of government in the private sector. While superficial indicators look good—GDP has grown significantly in recent years—this resulted from a global increase in a single commodity price (oil), rather than increased performance of the Iranian productive sector at large.

2. Khomeini’s Personal Beliefs

Ruhollah Khomeini was obviously not beholden to Western capitalist ideals of prosperity, nor did he believe those ideals had a place in an Islamic society. His personal economic beliefs likely stem from two primary places: First, his rural upbringing, and second, his extensive study of the lives of the Prophet Muhammed and his Companion, the fourth Rightly Guided Caliph Ali bin Abi Talib. The life stories of these two men

⁷⁷ Kuran, *Islam and Mammon*, 6.

combined with Khomeini's own personal upbringing of relative impoverishment to impart an affinity for the ascetic life that influenced Khomeini's personal economic philosophy, as well as his model for economy of an Islamic state.

Khomeini was born in the small town of Khumayn, approximately 60 miles southwest of Tehran, in 1902.⁷⁸ His early life was marked by personal tragedy, religious indoctrination and study, and significant political turmoil in Iran. The death of his father when Khomeini was five months old, and the death of his mother and aunt when he was age sixteen, encapsulated a period that also saw the constitutional revolution in Iran. Khomeini began studying religion early in life, and the Spartan lifestyle dictated by his rural setting combined with the ascetic influences of Islam's early leaders to mold his early personality (remarked by his elder brother as being very serious, dedicated, and pious for one so young).⁷⁹ As a young religious student, Khomeini witnessed the ascension of the Pahlavi dynasty to ultimately supplant the Qajar dynasty, and the contrast between the opulence of royalty—and the corruptness of that particular royal court—was such a contrast with his own personal philosophy that Khomeini was openly critical of the regime very early in his religious career.⁸⁰

Khomeini's admiration for the lifestyles of the Prophet Muhammed and Caliph Ali were consistent themes in his speeches shortly before the Islamic revolution. Khomeini praised the austere lifestyle of the Prophet, often comparing it with the ostentatious lifestyles of contemporary Islamic rulers, and believed that it was the egregious expenditures of royal courts on pomp and ceremony that resulted in subordination of the Muslims to foreign powers. Khomeini said,

Most forms of corruption originate with the ruling class... and the libertines who associate with them. It is these ruler who establish centers of vice and corruption, who build centers of vice and wine drinking, and spend the income of the religious endowments constructing cinemas... If it were not for these profligate royal ceremonies, this reckless spending, this constant embezzlement, there would never be any deficit in the

⁷⁸ Ruhollah Khomeini, *Islam and Revolution*, trans. Hamid Algar (Berkeley: Mizan Press, 1981): 13.

⁷⁹ Khomeini, *Islam and Revolution*, 13.

⁸⁰ Ray Takeyh, *Hidden Iran: Paradox and Power in the Islamic Republic* (New York: Times Books, 2006): 11.

national budget forcing us to bow in submission before America and Britain and request aid or a loan from them.⁸¹

Regarding Ali, Khomeini once remarked, “Even though that excellent man ruled over a vast realm that included Iran, Egypt, Hijaz, and the Yemen among its provinces, he lived more frugally than the most impoverished of our students.”⁸² He would also use Ali as an example of how the rule of the Imam could and should be used to correct social injustices. From this central point of the appropriate role of the Imam as both spiritual and political leader of the state, Khomeini developed his idea of sovereignty of the jurist, *velat-i-faqih*. When this philosophy was finally put to practice following the Islamic revolution in Iran, the ideal of social justice ultimately was used to create policies that ensured the authority of the state over all matters of life—especially the economy.

B. IRAN’S VERSION OF ISLAMIC ECONOMIC GOVERNANCE

1. Competing Visions Within the 1979 Islamic Revolution Regarding Islamic Economics

The concept of justice is a central theme in Islam from its very beginnings. The idea of social equality and justice applied across the spectrum of society’s classes, proffered by the Prophet Muhammad, was one of the key factors that enabled Islam to spread as far as it did in such a short time.⁸³ Islamic economics, as a model for an entire state’s economic system, represents an ideal to further “a just and humane society, without the exploitation, domination, alienation, and other social ills that have afflicted contemporary... economies.”⁸⁴ The idea of fairness of all aspects of a society is critical to Islam’s perceived primacy among its followers; the lack of justice and fairness of Iranian society under the Pahlavi regime was a main criticism leveled by Ayatollah Khomeini.

⁸¹ Khomeini, *Islam and Revolution*, 58.

⁸² Khomeini, *Islam and Revolution*, 57.

⁸³ Sohrab Behdad, “A Disputed Utopia: Islamic Economics in Revolutionary Iran,” *Comparative Studies in Society and History*, 36:4. (October 1994): 775.

⁸⁴ Behdad, “A Disputed Utopia,” 775.

According to Khomeini, in an Islamic state—which, in his opinion, required an Imamate governed by *shari'a*—unconditional subordination to the state was a religious requirement. When speaking about the appropriate nature of an Islamic state (prior to the Iranian Islamic Revolution), Khomeini said,

It is also our duty to follow and obey the holders of authority, who, according to our beliefs are the Imams (upon whom be peace). Of course, obedience to their governmental decrees is also a form of obedience to God. Since God Almighty has commanded us to follow the Messenger and the holders of authority, our obeying them is actually an expression of obedience to God.⁸⁵

Thus, the state bears the authority of God in all instances, and disagreement with the actions of the state is an act of apostasy. This is a critical point to understanding the complete subordination of all civil and economic aspects of the Iranian society to the government. Further, the case of the Iranian brand of Islamic economics is unique, as Behdad points out, not only because of its distinct radicalism in comparison to other Muslim countries, but because of the totality of Islamic social order that was created following the 1979 revolution. This totality represents an achievement in Islamization that has so far not been achieved through social reform in other countries.⁸⁶

As part of this Islamization, the nascent revolutionary government found more than ample theological justification for the role of the government as guarantor of social justice through direct economic participation. One of the principle sources of this justification came from the respected Islamic theologian Muhammad Baqr al-Sadr. Al-Sadr was a notable Islamic scholar who had supported the Iranian revolution and had written specifically on the subject of an Islamic economic system. His definitive work on the subject, *Iqtisaduna (Our Economics)* is still the work of record for many in the Islamic world.

Although some within the Islamic community criticized al-Sadr for insinuating that Islam and capitalism were not only compatible but had common basic ideals, al-

⁸⁵ Khomeini, *Islam and Revolution*, 91.

⁸⁶ Behdad, “A Disputed Utopia,” 776.

Sadr's notion that Islamic economics was based on the notions of justice, fairness, and equality created a model that the Iranian Islamic revolutionaries could use to justify the role of the state in all aspects of life in the country.⁸⁷ While al-Sadr believed in private property rights, they were (in his view) neither inherently natural nor irrevocable. Individuals, he believed, must look after the greater welfare of society, as proscribed by Divine Revelation, in exercising their private property rights.⁸⁸

Critically for the post-revolutionary government in Iran, al-Sadr proposed that the role of the state is to be a "positive check" on individual action, should those actions harm the welfare of society (as determined by the state). Behdad states, "Social justice in an Islamic society, according to Sadr, is based on the principles of individual cooperation and state intervention."⁸⁹ This is important to understanding the basis for authority of the Iranian government with regard to wealth and power. The government reserves the right to declare that any individual's wealth is "excessive" and contrary to the public good. In such a case, that person's wealth may be "redistributed" at the discretion of the state.

This aligns with the generally accepted belief among Islamic theologians that real property ownership can belong only to God. The *Qur'an* (III:129) reads, "Unto Allah belongeth whatsoever is in the heaven and whatsoever is the earth," and this (and similar passages) are interpreted as being a limit on the private property rights of individuals. This is significant to the Iranian Islamic regime, since in the philosophy of *velat-i-faqih* (sovereignty of the jurist) places the Imam as God's representative on earth until the return of the Mahdi (awaited one). Thus, the Imam, and therefore the government, has the legal and moral legitimacy to determine the appropriate right to property of the people.

⁸⁷ Behdad, "A Disputed Utopia," 790–791, 792.

⁸⁸ Behdad, "A Disputed Utopia," 787.

⁸⁹ Sohrab Behdad, "A Disputed Utopia," 788.

2. Iranian Economics Following the Revolution: Idealism Becomes Authoritarian Populism

Prior to the 1979 Islamic Revolution, proponents of Islamism in Iran presented little awareness of Islamic economics as a unique field of Islamic philosophical thought. As a result, following the revolution the political left heavily influenced formation of Iran's economic system under Islam.⁹⁰ Several prominent figures contributed to the sociological discourse that would eventually form the precept for Islamic governance in Iran. Those revolutionaries with leftist (i.e., non-free market/capitalist) economic views were able to find common cause with several prominent Islamist figures at the time (such as al-Sadr, Shariati, and Banisadr). The left used many of al-Sadr's economic principles regarding the role of government and the dangers of excessive accumulation of wealth in individuals to insinuate themselves in the prevailing economic thought. Behdad summarizes al-Sadr's position on the role of the state in ensuring social justice through economic controls:

Everyone in a society must benefit from a socially acceptable standard of living, with variations only accounted for by differences in individuals' drive and capacity... [and the] state must (1) own and operate those enterprises that require a high degree of concentration of capital, since individuals cannot/should not possess such a large mass of capital; and (2) [the] state must be continually engaged in the market to appropriate excessive accumulations.⁹¹

There were other notable sources of justification for this interventionist role of government in the economic system, chief among them was Ali Shariati. Shariati added to the left-leaning view of economics by his negative view of capitalism and private ownership—which he viewed as the source of all social ills and detrimental to a just and equitable society. He believed in a struggle to a classless society, akin to many who subscribed to Marxism. Given Shariati's role and influence on the Iranian Revolution

⁹⁰ Sohrab Behdad, "Revolutionary Surge and Quiet Demise of Islamic Economics in Iran," in *Talk given 4 October 2005 to the Center for Near Eastern Studies, UCLA* (Los Angeles: Center for Near Eastern Studies, 2005), 5.

⁹¹ Behdad, "Revolutionary Surge," 7.

with regard to social ideology, his view of an appropriate economic system was a significant influence in the early days of the Islamic Republic.⁹²

Abulhasan Banisadr, first President of the Islamic Republic of Iran, and an economist trained at the Sorbonne, represented a more classically educated (in the secular, Western sense) member of the revolution. His economic philosophy was influential, as Banisadr was deputy and later Finance Minister prior to ascension to the presidency. Banisadr represented more of a hard-leftist view of economics; he believed labor to be the foundation of ownership and that accumulation of wealth represented dominance and coercion that created a false manifestation of scarcity. Banisadr, crucially, rejected the appropriative power of the state, believing that it would lead to accumulation and coercion by the state itself. This rejection of the role of the state separates Banisadr from the religious philosophers of Islamic economics and eventually limited the penetration of his economic ideals into Iranian society.⁹³ Ironically, his notions regarding the coercive danger of accumulation would be used by the state for its own political ends to justify the appropriation of private property from potential opposition forces (just the kind of thing Banisadr ultimately feared). While Banisadr's falling out with Khomeini led to his exile, it is highly likely that his institutional influence in Iran's economic system remained for some time later.

In an attempt to consolidate power and institutionalize the principle of *velat-i-faqih*, on 21 April 1980 Ayatollah Khomeini, now installed as the Supreme Leader of the Islamic Republic of Iran, declared that Iranian universities were "centers for propagating 'Eastern and Western ideas,'" and closed those institutions to facilitate the "reconstructing" of humanities and social science textbooks.⁹⁴ The work concentrated heavily on economics and eventually issued the volume *Introduction to Islamic Economics*. Significantly, this work broke with traditional jurist thought by declaring Islamic economics very compatible a market-based, neoclassical economic system. The authors (doctors of seminaries known as the *modarressin hozeh-ye'elmi-ye*, or

⁹² Behdad, "A Disputed Utopia," 777–778, 784; Behdad, "Revolutionary Surge," 8.

⁹³ Behdad, "A Disputed Utopia," 793–795.

⁹⁴ Behdad, "A Disputed Utopia," 796.

Modarressin, assisted by professional economists) adhered to the least restrictive interpretations on the limits of private property rights and free markets. The Modarressin explicitly recognized the need to balance economic growth against social equity and, in contradiction to Sadr and Banisadr, recognized the profit motive and the rationality of market prices.

Also in opposition to traditional Islamic economic theorists, the Mondarressin argued that one's own direct labor is not a limiting feature on one's ability to benefit from the "fruits of nature." Traditionally, it was felt that one should not profit from wage labor by others to cultivate a natural resource. As an example, if a farmer could not personally farm all of his land, he could hire people to cultivate the land, but he could not profit from their labor himself. Instead, he would need to divide up the profit amongst the workers, keeping no share for his own. This is in keeping with the idea that ultimately only God may own the land, and those who work the land are entitled to all its rewards directly; the only source of ownership is work, according to the traditional scholars. The Mondarressin, on the other hand, believed that workers needed only to receive "fair" wages, and this, in turn, helps out those who may not be able to labor themselves. The Mondarressin argument in favor of this rests in their opinion that whatever individuals own "is either based on direct labor or by the use of their property which has its origin in their labor or the labor of those who have transferred such ownership to them."⁹⁵

Key to the acceptance of this philosophy was its endorsement by Khomeini, who had made several legal rulings in line with the Mondarressin economic reasoning. Khomeini had no problem with market-based capitalism, as such, so long as it did not interfere or challenge the monopoly on legitimacy maintained by the jurist. Khomeini is distinct in iterating the supremacy of the Islamic government, and the Supreme Leader in particular, in all matters of life in Iran. Regarding how this manifested itself in an economic ideology and the limits of private ownership, Behdad says,

He leaves no doubt that Islam sanctions property ownership, but that sanction is based on the legitimacy of the source. In 1979 when the Revolutionary Islamic Courts were engaged in extensive expropriation of

⁹⁵ Behdad, "A Disputed Utopia," 798.

property, Khomeini added, “we will deal with these big capitalists, whose capital and wealth could not have become so large from legitimate sources.” Moreover, Khomeini states, “even if we assume someone has legitimate properties but the Islamic judge or *vali-ye faqih* realizes that an individual’s having so much will adversely affect the welfare of Muslims, he can expropriate those properties.”⁹⁶

Thus, the economic ideology of Iran became solidified shortly after the revolution: the individual, under Islam, had a right to private property. But the limits of the right were to be determined by the supreme jurist under the auspices of social justice. As a result, the state could expropriate property as it saw fit, for whatever reasons it saw fit.

In addition to this philosophy regarding personal property, Khomeini’s government subscribed to other tenets of Islamic philosophical thought that empowered the state. Another such example is the role of government and private enterprise. Al-Sadr, Shariati, and Banisadr all see a role for government in operating the large engines of production. Though they each have their own thresholds of the ultimate extent of governmental participation, these three generally agree that an Islamic government is the best repository for control of large companies and other capital-intensive organizations. The rationale is that when the large companies are controlled by individuals, those people become inordinately wealthy and contribute to social disparity. The concern of these wealthy individuals becomes enhancing their own wealth and power, not the welfare of the wider Islamic community. The wealthy individual, in Khomeini’s view, cannot be relied upon to safeguard the justice and harmony in the community of Muslims (the *umma*). On the other hand, the Islamic government headed by the Imam has but one concern: social justice according to the *Qur’an* and the tenets of Islam for the community as a whole.

This notion legitimized the Islamic revolutionary government’s economic policies of nationalization during and after the revolution. During this period, what Behdad terms the “Revolutionary Disruptions,” the nationalizations began as worker takeovers of plants

⁹⁶ Behdad, “A Disputed Utopia,” 806.

where the ownership had fled the country in advance of the Islamic Revolution.⁹⁷ Immediately following the consolidation of the Provisional Revolutionary Government, however, real nationalization began in the summer of 1979. Banks, insurance companies, and some large manufacturing enterprises were confiscated and became state-owned.

In furtherance of the Islamic economic philosophical view that individuals could be a threat to the social justice of the state, the Revolutionary Islamic Courts seized the assets of many deemed “anti-revolutionary.” These were then declared under “public ownership”—an important distinction in Islamic jurisprudence, as it is separate from state ownership. “Public” entities are at the sole disposal of the Imam to determine their appropriate use in “strengthening Islam and [the] society of Muslims.”⁹⁸ Khomeini formed special foundations to direct “public” assets, and the takeover of companies by the government for the purpose of making them “public” became, at times, a means of mass mobilization used by the regime.

Understanding the Islamic philosophical difference between “public” and “state” property is important to framing the issue. In Islamic jurisprudence, if property is appropriated for the “public,” the state “may use [the property] in such a way that all the public, without specific exclusions, may benefit.” According to al-Sadr, schools and hospitals are examples of legitimate public property. But “state” property, on the other hand, can benefit special groups; such as to benefit people needing investment assistance. The determination of what is public and what is state is made by Islamic law (Behdad gives the example of conquered lands prepared for cultivation as “public” and “state” if it is unprepared).⁹⁹

The emplacement of the Islamic Republic of Iran’s formal Constitution did little in the long run to assure any right to property of the individual. Article 44 of the Constitution is explicit, stating that, in its desire to champion the oppressed over the oppressors, it diminishes the role of the private sector of the economy and relegates it to a

⁹⁷ Sohrab Behdad, “From Populism to Economic Liberalism: The Iranian Predicament,” in *Iran’s Economy: Dilemma of an Islamic State* (New York: I.B. Tauris, 2000): 2.

⁹⁸ Behdad, “From Populism to Economic Liberalism,” 2.

⁹⁹ Behdad, “A Disputed Utopia,” 788.

supplanting role to the state and cooperative sectors. What criteria for the classification of protected private property are laid out in Article 49 are vague and obviously designed to ensure that any property may be declared illegitimate by the jurist.¹⁰⁰

The ease with which Islamic economic philosophy, as articulated by Khomeini and the Iranian Constitution, transformed into economic populism is strikingly clear. The direct causes of this transformation are also, in retrospect, also clear. First, the need to consolidate power behind the Khomeini's regime necessitated continued appeasement of its socio-political base: the rural peasantry. Secondly, the initiation of the Iran-Iraq War so shortly after the formation of the Islamic government exerted tremendous social pressure on the Iranian people. The cost in terms of lives lost and the dire economic impact of the eight-year struggle combined to consistently threaten the regime from within. After the June 1981 removal of President Banišadr, the lone secularly-trained influence on the new regime was gone and the religious establishment assumed control of all aspects of the state. Consequently, the debates regarding the clerics' different economic philosophies were thrust into the public view.

Specifically, the clerical conflict was between those of the populist/statist ideological interpretation on the left (those of the al-Sadr ideology) and those on the right with what Behdad calls the "*laissez faire*" policy. The former group argued for extensive state control over the entire economy and the latter for a more free-market approach. For those of the *laissez faire* disposition, the concern was the prohibition of unacceptable practices (*riba*, deceit, theft, production of alcohol and pork, monopoly, conspiracy, and price fixing to create monopolies), not state intervention in the economy or redistribution of wealth.¹⁰¹ The conflict between these two camps bore out between the *Majlis*, a body dominated by the populists, and the Council of Guardians, which had to approve all laws enacted by the *Majlis* and tended toward a more free-market approach. Through most of the Iran-Iraq War period, the *Majlis* would pass laws that were decidedly populist, only to

¹⁰⁰ Behdad, "From Populism to Economic Liberalism," 3.

¹⁰¹ Mehrdad Valibeigi, "Islamic Economics and Economic Policy Formation in Post-Revolutionary Iran: A Critique," *Journal of Economic Issues* 27, no. 3 (September 1993): 798. Behdad, "A Disputed Utopia," 798.

have them rejected by the Guardian Council as un-Islamic. This left Ayatollah Khomeini as the final authority, and his support for either side was inconsistent.¹⁰²

As a result of the often-irreconcilable differences between the two bodies of government, economic policy during this period was mostly ad hoc and undertaken to avert serious crises and forestall potentially disastrous economic failures. Consequently, the 1980s was a period of no real economic planning and hobbled development. The exigent burdens of the Iran-Iraq War placed additional stress on Iran and its economy. The ad hoc nature of economic policy meant that most of the non-hydrocarbon production during this period was for war-related products, which created few expansive effects on the overall economy. Chapter IV will discuss the Iranian economy during the Iran-Iraq War more thoroughly, but suffice it to say that the war's heavy reliance on numbers of troops in place of military hardware and technology meant that the industrial capacity of Iran atrophied during the conflict and, as a result, the anemic industrial sector was unable to boost the economy in the post-war period (as is often seen after long conflicts when the means of production shift from producing war materiel to consumer and industrial products).

The stalemate between the *Majlis* and Guardian Council during this period reached such an impasse that, in February 1988, Khomeini created the "Assembly for Discerning the Interests of the System of the Islamic Republic" (also known as the "Expediency Council"). This 13-member council existed to resolve disputes between the *Majlis* and the Guardian Council.¹⁰³ Empowered with legislative authority to create and pass laws (which were limited to three years of efficacy), the Expediency Council was created to be the bridge between the two conflicting governmental bodies. Failing a resolution to the disputes, the Expediency Council could at least provide ad hoc solutions to prevent the complete seizure of government from the deadlock between the *Majlis* and

¹⁰² Valibeigi, "Islamic Economics and Economic Policy," 798; Behdad, "From Populism to Economic Liberalism," 6.

¹⁰³ Valibeigi, "Islamic Economics and Economic Policy," 799.

Guardian Council. Valibeigi credits the creation of the Expediency Council, and the death of Ayatollah Khomeini not long afterward, with the rise of a more pragmatist economic philosophy in Iran.

The conditions that deadlocked the Iranian government's policy-making bodies did not arise by coincidence, but were instead a direct result of Khomeini's actions. The *Majlis*, as representative of the generally rural peasantry that supported the Islamic Revolution, was naturally predisposed to a populist economic philosophy. This segment of the society had been generally excluded from what prosperity was realized under the Shah. As Iran developed, and focused mostly on its hydrocarbon and manufacturing sectors, the rural and agrarian populations did not see a corresponding rise in their standard of living. The rural to urban migration that coincided with the Pahlavi development strategy further aggravated tensions among the poor. For the less well-off, the 1979 Iranian revolution was as much about socio-economic disparity as it was a religious movement. Khomeini's promises of social justice through Islam and the validity of redistribution of wealth under the banner of Islamic jurisprudential legitimacy were highly motivating to this population, and they were a key source of Khomeini's support.

The Guardian Council, on the other hand, represented influential elements of the clerical establishment as well as the *bazaaris*, the historical Iranian merchant class. Both these groups had philosophical leanings toward private enterprise and market economies, as well as belief in the legitimacy of the individual's right to pursue wealth through business. While *ulama* did believe that there was an appropriate role for the Imam to ensure social justice is not infringed by the wealthy and powerful, they did not necessarily believe the state should be the main engine in the economy. Khomeini needed the *ulama* and the *bazaaris* as much as he needed the peasant class. The *ulama* provided legitimacy to his religious interpretations (Khomeini was not a Grand Ayatollah and, thus, had not reached the status of emulation where his rulings became *fatwa*, or a ruling of Islamic law that adherents are required to follow) and the *bazaaris* ultimately had the expertise to make the non-state sectors of the economy work. As a result of the attempt to satisfy both political camps, Khomeini created a system in which he was the

continual tie-breaker. The drawback, however, was that after Khomeini's death the populists retained their ability to hobble the more progressive economic plans of the Rafsanjani and Khatami administrations.

Following Khomeini's death on 6 June 1989, the position of the Presidency of the Islamic Republic of Iran grew in prominence and influence with regard to domestic political and economic agendas. While the elevation of Ayatollah Ali Khamenei to the post of Supreme Leader meant he technically inherited all the Constitutional powers of his predecessor, he lacked much of the personal charisma and gravitas which Khomeini possessed that bound so many to him and allowed him to exert influence across claimants in the revolution. Khamenei, a former president of Iran under Khomeini, lacked the ability to resolve disputes through personal influence in the way his predecessor had. Khamenei was the compromise choice of the hard right clerical establishment after the fall from favor of Khomeini's previously anointed successor, Ayatollah Ali Hussein Montazeri; and Khamenei's "lackluster theological credentials" meant that he lacked the ability to stand independent of the support of the clerical establishment. The hard-right clerics, in turn, depended on Khamenei's position as Supreme Leader to enact their conservative religious agenda.¹⁰⁴

According to Takeyh, this lack of a decisive political figure in Iran that could either unite the disparate parties, or issue decisions acceptable because of the legitimacy of the personal authority of the Supreme Leader led to conflict and impasse as the competing factions within the government fought for influence:

The simmering conflicts that had been held in check by Khomeini's authority now became all too evident... In essence, the tensions between the regime's revolutionary ideals and its practical requirements burst to the surface, bedeviling Iran's new rulers. Without Khomeini available to resolve these disputes, stalemate and deadlock became the new currency of Iranian politics.¹⁰⁵

¹⁰⁴ Ray Takeyh, *Hidden Iran: Paradox and Power in the Islamic Republic* (New York: Times Books, 2006), 33.

¹⁰⁵ Takeyh, *Hidden Iran*. 31.

Khamenei has proved an adroit political operator, however, and has not just survived as Supreme Leader for twenty years, but has managed to inculcate the conservative political ideology in Iran's non-elected political institutions. The militant conservative control of the Guardian Council, the Supreme Leader's office, the judiciary, the Revolutionary Guard Corps (the parallel to the conventional armed forces, under the direct control of the Supreme Leader), and the *basij* (the volunteer paramilitary militia often used as a coercive force) all serve to ensure the political hegemony of the conservative religious ideologues.¹⁰⁶

As Chapter IV will show, the conflict between conservative ideology, populism, and more progressive elements in the Iranian government illustrated in this chapter created an economic system where, despite attempts at central planning by reformers to develop the Iranian economy has failed to meet its development potential. The influence of populists and hard liners continually prevented effective reform of the economy. The election of Mahmoud Ahmadinejad to the Presidency in 2005 resulted in dismantlement of the potential for economic development in Iran through a combination of hard-line conservative political rhetoric, courting of international economic sanctions (through pursuit of nuclear enrichment), and domestic populist ideology. Hydrocarbons have formed the greatest portion of expansion in Gross Domestic Product (GDP) since the year 2000, and the current regime has used this to fund extensive domestic subsidies to effectively buy political quietism. These subsidies, estimated at between 18% and 30% of GDP, represent a significant shackle on potential development.¹⁰⁷

¹⁰⁶ Takeyh, *Hidden Iran*, 34.

¹⁰⁷ Carnegie Endowment for International Peace, "Iran's Economic Health and the Impact of Sanctions," Summary of comments made 27 April 2010 in Washington, D.C. Downloaded 13 August 2010 from: www.carnegieendowment.org.

In the end, the death of Ayatollah Ruhollah Khomeini was also the death of the last vestiges of the attempt to transform Iran into an Islamic economy in keeping with a consistent philosophical approach. The problem was that Khomeini created a system dependent on his personality to function, not necessarily on a specific set of consistent Islamic economic ideals. After his death, the Iranian economy became another issue of contestation between the competing ideals of the populists and the pragmatists. While economic progressives held the Presidency from 1989 until 2005, the populists in the *Majlis* and the hard-line ideology of Khomeini's successor, Ayatollah Khamenei, checked their plans for economic development. Ahmadinejad's ascendancy to the Presidency in 2005 further entrenched the power of populism and has increased state involvement in the private sector through by using the Revolutionary Guard Corps to control formerly private companies. These actions, behind the banner of Khomeini's revolutionary ideals of the proper role of the state to guarantee social justice, indicate that the establishment of a true Islamic economic establishment in Iran will not happen in the near future.

IV. THE IRANIAN ECONOMY (1979–2009)

A. THE ECONOMY BEFORE THE ISLAMIC REVOLUTION

Central economic planning was the method favored by the Iranian government for 30 years before the revolution and originated in the wake of the systems developed in the Soviet Union, China, and India. Unlike these countries, Iran's was not a comprehensive input-output based plan; rather, it issued expressions of official intent with regard to the distribution of oil-export revenue among public investment projects.¹⁰⁸ At the time, Iran's "technocratic" approach to economic development (increasing output by encouraging either the adoption of improved technology or by increasing greater incorporation of conventional inputs, such as capital) seemed in line with the country's stated "liberal capitalist ideology."¹⁰⁹

The problem, however, lay in the execution of this capitalist ideology. Rather than trusting in the private sector, where the free-market and competition would combine with Adam Smith's "hidden hand" to achieve economic progress, in the Pahlavi state property ownership was "highly concentrated" in a trusted few closest to the regime.¹¹⁰ In this case, the technocratic approach served only to increase the disparity in income among the population. This was welcomed by the state, as its theory was that the very wealthy would be able to turn a greater percentage of this income around and reinvest it, thereby increasing the relative rate of economic output. This policy was unfortunate for two reasons: first, the obvious popular discontent fueled by the relative deprivation of the vast majority of the population compared to the few well-off social and political elites. Second, further analysis showed that reducing the disparity in income would actually have *raised* the national output and *lowered* unemployment and under-employment since the rate of increase of consumption of a population usually outpaces the rate of increase

¹⁰⁸ Jahangir Amuzegar, "Iran's Post-Revolutionary Planning: The Second Try," *Middle East Policy*, III:1 (March 2001): 25–26.

¹⁰⁹ Looney, *Economic Origins of the Iranian Revolution*, 258.

¹¹⁰ Looney, *Economic Origins of the Iranian Revolution*, 258.

in saving.¹¹¹ The Pahlavi economic policies sowed the seeds for the revolution, both in terms of social disparity as well as economic under-performance.

In the immediate aftermath of the revolution, the idea of central economic planning was maintained largely because of the influence, at the time, of Islamist Marxists and “left-leaning populist clergy.”¹¹² To complicate the process, however, the Khomeini regime also added social and cultural aspects to the existing economic planning process. Khomeini’s notions of *velat-i faqih* (sovereignty of the jurist) meant that he, and the Supreme Leaders who would follow him, must have governance over all aspects—cultural, religious, social, and economic—of the *umma*. Thus the ideas of economic development are subordinated to the interests of the social development of the state. This made what was a difficult task under the Shah’s anemic administrative capacity nearly impossible in the post-revolution Islamic state.

B. THE IRAN-IRAQ WAR

Further complicating the task of developing the Iranian economy after the 1979 revolution was the war with Iraq that began in 1980 and consumed a majority of the military, political, social, and economic resources of the country for the following decade. The Iran-Iraq War prevented the type of centralized economic planning that had characterized the Pahlavi state.¹¹³ Two reasons for this likely exist. The first, and most obvious, reason is that the war was an economic catastrophe for Iran. The effects of the war on the Iranian economy will be examined in greater detail subsequently, but for now it is sufficient to say that the constant and severe tax on Iran’s resources of blood and treasure limited it to ad hoc economic policy rather than well thought out development strategy.

The second reason for the hiatus of central economic planning was its lack of appeal to Ayatollah Khomeini. The man unconcerned with the price of watermelons was

¹¹¹ Looney, *Economic Origins of the Iranian Revolution*, 259.

¹¹² Amuzegar, “Iran’s Post-Revolutionary Planning,” 26.

¹¹³ Anonymous, “Iran.” *Oxford Economic Country Briefings: Iran*, (August 19, 2009): 1–5. <http://www.proquest.com/> (accessed 9 March 2010).

similarly unconcerned with the economic factors affecting the price of the watermelon in the first place. Evidence supporting this is found in the elevation of economic issues to a place of primacy in the regimes that followed Khomeini.¹¹⁴ This was a subtle, though tacit, rebuke of that part of the Supreme Leader's guidance.

It is difficult to emphasize the severity and rapidity with which the Iran-Iraq war wrecked the Iranian economy. By the end of 1981 foreign exchange reserves fell from \$14.6 billion at the end of the Pahlavi regime, to \$1 billion at the close of 1981. While the government initially relied on oil production to sustain the economy, the increases of 1982 and '83 (to \$19 billion from \$12 billion in 1981) were not sustainable. By 1984 and '85, revenues were back at \$12–13 billion and continued to fall (\$6.6 billion in 1986). The consequential 50% unemployment by 1987 resulted in the government creating schemes to mobilize labor (specifically in the agricultural sector) by exempting members of "The Reconstruction Campaign" from military service and sending them instead to rural areas. Additionally the government sought to ration precious foreign currency by limiting imports of "non-essential" products.¹¹⁵

As for the idea of a truly Islamic economic system in Iran, one could consider it a casualty of the Iran-Iraq War as well. Behdad states,

The war with Iraq, economic sanction, and above all, the decline in oil revenues of Iran in 1985 and 1986 brought the utopian project in construction of an Islamic economic order to a dead end. In nearly a decade of social turmoil, war, and ad hoc policy making, the productive capacity of the economy had dwindled... The only manifestation of Islamization of the market was the replacement of interest rates with an elaborate system of fees, awards, lottery and "guaranteed profit" in the state banking system... [T]here was little to show for Islamic economics in the Iranian society. Islamic economics had obviously failed, the project of economic liberalization, with all its bells and whistles, began.¹¹⁶

¹¹⁴ Amuzegar, "Iran's Post-Revolutionary Planning," 26.

¹¹⁵ Karsh, *The Iran-Iraq War*, 74–75.

¹¹⁶ Behdad, "Revolutionary Surge," 15.

C. ECONOMIC DEVELOPMENT AFTER THE IRAN-IRAQ WAR

1. The First Development Plan: 1989–1993

Following the conclusion of the Iran-Iraq war, the imminent need to restore the nation to a functioning economic foundation was obvious. Precipitous to this was the death of Khomeini in 1989, which allowed more economically progressive personalities to influence the country's policies. The election of Ali-Akbar Hashemi Rafsanjani in 1989 signaled the arrival of a bazaar and market-friendly political group whose focus would be the economy as a method to improve the livelihood of Iranians. The Rafsanjani government's decision to enact the "structural adjustment program" which came to be known as the First Development Plan was "a substantial turn toward a new global paradigm."¹¹⁷

The first Plan entailed a complete restructuring of the Iranian economy that would decouple the government from control in the private sector, reduce the trade protectionism that was used in a (misguided) attempt to stimulate domestic production, unification of Iran's fracture exchange-rate system, tax reform, reorganization of the banking system, and cost-price adjustments to deal with inflationary pressures.¹¹⁸ While the free-market orientation of this plan belies its origins in central planning, this resulted from the decimation of the Iranian private sector in the aftermath of the Revolution and the war with Iraq. There were no institutions at the time capable of stimulating the type of market activities the Rafsanjani government wanted; the only path, they believed, was for the government to guide privatization and modernization.

Several unique factors helped the Iranian economy during the First Development period that propelled the nation's economic performance to unseen post-revolution levels. First, a large and relatively unused industrial capacity that was no longer required to devote production to the Iraq war.¹¹⁹ While Iraq fought the war with a strategy centered

¹¹⁷ Amuzegar, "Iran's Post-Revolutionary Planning," 26, 27.

¹¹⁸ Amuzegar, "Iran's Post-Revolutionary Planning," 26.

¹¹⁹ Amuzegar, "Iran's Post-Revolutionary Planning," 26.

on the use of a modern military that required the national support of heavy industry, Iran's strategy centered on the use of men vice equipment.¹²⁰ This strategy robbed the industrial sector of much of its workforce and hobbled what capacity remained by requiring it to produce goods solely in support of the war. Second, oil prices rose sharply in the years immediately following the Iran-Iraq war (with a significant peak after Iraq's invasion of Kuwait).¹²¹

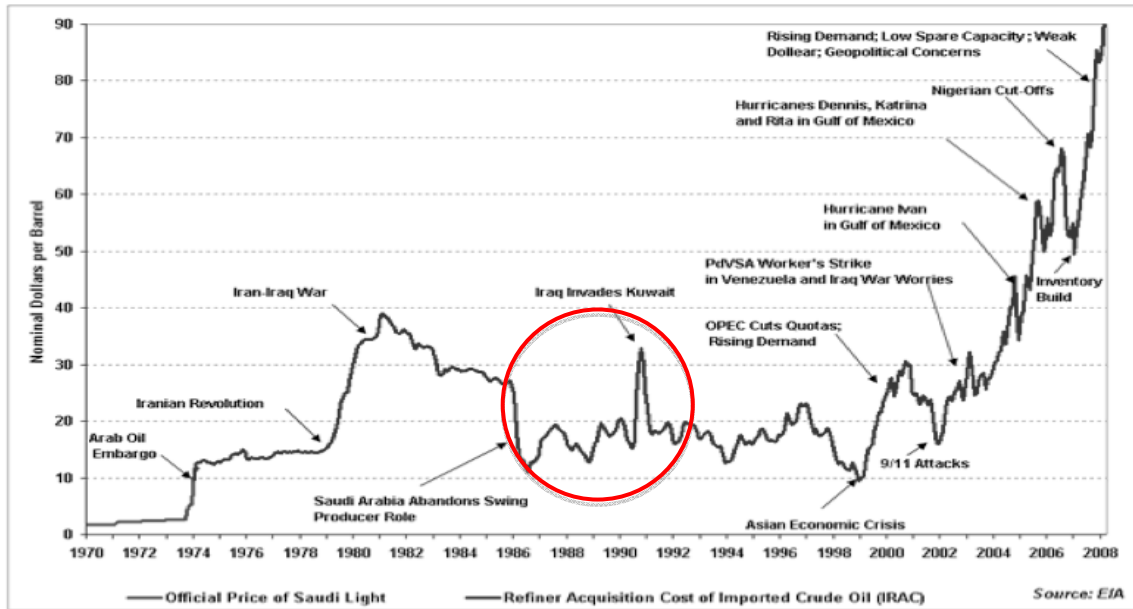


Figure 1. Oil price per barrel (in USD). Highlighted period reflects period covered by First Development Plan. From U.S. Energy Information Administration, 2007¹²²

The importance of oil for the Iranian economy rose dramatically during the war with Iraq. Military expenditures rose as oil revenues declined (initially, due to the inherent difficulties of getting oil to market during the war) to a point that Iran's foreign exchange reserves of \$14.6 billion—inherited from the Shah's regime—was reduced to only \$1 billion by 1981. The government forced national industries to mobilize in

¹²⁰ Karsh, *The Iran–Iraq War*.

¹²¹ Amuzegar, "Iran's Post-Revolutionary Planning," 26.

¹²² United States Energy Information Agency, "Annual Oil Market Chronology," *Country Analysis Brief*, July 2007, accessed 25 August 2010, www.eia.doe.gov/emeu/cabs/aomc/overview.html

support of the war effort and this left little spare capacity to create value added goods to be sold for revenue. This is why for the majority of the war the Iranian government focused on oil production as its main source of economic production.¹²³

Third, the Rafsanjani regime made extensive use of short-term commercial credits to spur economic activity.¹²⁴ These credits were necessary to spur the type of private-sector economic activity that was absent for most of the war. Specifically, the aim was to enlarge Iran's anemic middle class, which had suffered due to state direction during the war years virtually eliminating private-sector growth.

The fourth helpful factor for the First Development Plan was that the population growth rate began to fall.¹²⁵ Due to the personnel centric nature of the Iranian military strategy during the Iraq war (meaning a strategy with extremely high casualty rates and a reliance on refilling those lost ranks), the regime and the *ulama* had for some time encouraged prodigious reproduction among the population as their religious and patriotic duty.¹²⁶ The state was not successful in this campaign and, by the time of the First Development Plan and the end of the war, the combination of low birth rate and loss of population during the war resulted in a smaller productive sector and a relative increase in production rates in the workforce.

The aforementioned factors combined to assist the First Development Plan in achieving an average GDP growth rate of approximately 7%—a significant improvement from the earlier years. However, the Plan was not categorically a success, as it failed to achieve many of its specific quantitative improvement targets; it was not uniform in improving sectors across the economy, and overall failed to meet some of its most ambitious goals. Specifically, by the admission of the Plan's architects, it failed to meet its desired goals in privatization as well as exchange and trade liberalization, due to poor implementation.¹²⁷ The result of this was a poor showing of the private sector of the

¹²³ Karsh, *Iran–Iraq War*, 74.

¹²⁴ Amuzegar, "Iran's Post–Revolutionary Planning," 26.

¹²⁵ Amuzegar, "Iran's Post–Revolutionary Planning," 26.

¹²⁶ Karsh, *Iran–Iraq War*.

¹²⁷ Amuzegar, "Iran's Post–Revolutionary Planning," 26–27.

economy (real GDP growth of 1.6%) and increasing short-term foreign debt that created inflationary pressures (at 35%) that affected the implementation of the Second Development Plan.

2. The Second Development Plan: 1995–2000

Due to the “considerable wrangling” over the benefit and intelligence of Rafsanjani’s structural adjustment program caused by the confluence of negative economic factors, the Second Development Plan did not follow immediately on the heels of the First. Rather, on the pretext of examining factors such as “earlier miscalculations, excessive credit-creation, foreign short-term borrowing, a slump in crude-oil prices, [and] a growing volume of external payment arrears,” the Majlis postponed starting the Second Plan from March 1994 until March 1995.¹²⁸ One of the largest causes for delay was the unsolved problem of Iran’s exchange-rate system.

One of the main goals of the First Plan was the unification of the multiple exchange rates that had been created to govern various sectors during the Iran-Iraq war. Because of the aforementioned macro-economic issues that arose following the war, the exchange rate was not unified until March 1993 (and then at a “floating rate” of 1,600 Iranian rials (RI) per dollar; a figure much depressed from the precursor rate of RI 70). The unified rate did not last for long, however, due to the Central Bank’s inability to access world capital markets, which limited its ability to service external debt and control inflation.¹²⁹ The government abandoned the unified rate in December 1993 and was further unable to sustain a second official rate of RI 1,750/dollar in May of 1994 as it was not sustained by the free-market rate. To combat this, the government re-instated strict controls on foreign currency allocation and trade, and created a special “export rate” of exchange of RI 2,345 to finance “non-essential” imports. Thus the government achieved a measure of reduction in their imbalances.¹³⁰

¹²⁸ Amuzegar, “Iran’s Post–Revolutionary Planning,” 27.

¹²⁹ Amuzegar, “Iran’s Post–Revolutionary Planning,” 27.

¹³⁰ Amuzegar, “Iran’s Post–Revolutionary Planning,” 27.

Iran's Second Economic, Social and Cultural Plan (the official name) began on 20 March 1995 amid dubious economic circumstances. The public sector, government provided subsidies and bureaucracy were disproportionately large; exacerbated inflationary pressures were constant; and poor management of state revenues, external debt servicing, exchange-rate regimes, and return on consumer savings against inflation by the government and financial system.¹³¹ As a result, the Second Plan was less about grand economic development, and more about fixing the broken parts of the Iranian economic system through accelerated structural reforms. While the economic calculations behind the Second Plan were more realistic than those of the First, the list of goals remained a hodgepodge collection of worn ideals. The quantitative targets, broken down to various categories and sub-categories (see Appendix A), reflected the continued desire to achieve increased growth (as measured by GDP) through an increase in private-sector investment and a relative decrease in government consumption.¹³²

Interestingly, many of the Second Development Plan's economic policies would fit well into those prescribed by today's Washington Consensus. Reduction of the size and scope of government in the business sector, improved rule of law, control of population growth through non-coercive means, increase in employment through enhanced education and training of the workforce, etc., were some the Plan's proposed methods of economic development.¹³³

Evaluating the relative success of the Second Development Plan is difficult, as reliable statistical data is scarce. A few conclusions can be made, however, from the data that is available. In general, external government debt and budget deficits were reduced and Iran was able to control its financial sector to the point where it could take tentative steps back into international financial markets (including World Bank loans). In general, the successes of the Second Development Plan were in reduction of rates of increase (of consumer prices, population, etc.), rather than wholesale reduction of aggregate numbers. More critically, however, to the overall evaluation of the Plan is the country's showing in

¹³¹ Amuzegar, "Iran's Post-Revolutionary Planning," 28.

¹³² Amuzegar, "Iran's Post-Revolutionary Planning," 28.

¹³³ Amuzegar, "Iran's Post-Revolutionary Planning," 30.

overall human-development rankings during this period. According to the UNDP, Iran fell from 78 to 97 among 175 countries listed on the human-development index. In looking at the global data for the period, while Iran improved relative to itself, other nations (19 of them) improved at a greater rate during this time frame.¹³⁴

3. The Third Development Plan: 2000–2005

President Rafsanjani's second and final (due to constitutional limitations) term expired in May 1997. His successor, Sayyed Muhammad Khatami assumed the Presidency halfway through the Second Development Plan and his administration was the sole architect of the Third Development Plan in 1998–1999.¹³⁵ From the beginning, the effort suffered the Herculean task of attempting to reconcile a program for economic growth and expansion with policy guidelines from the Supreme Leader, Ali Khamenei, to “pursue frugality and parsimony in consumption,” as well as other mandates to encourage adherence to the late Ayatollah Khomeini's “religious and political thoughts.”¹³⁶

As with previous development plans, the one submitted to the Majlis concerned itself with decoupling the government from Iran's anemic state-dominated economy and moving the economy toward a more internationally-oriented free market, a reduction of reliance on oil exports, privatize the largest industries, movement off rentier economics, reduction of subsidies, and a general removal of government interference in the private sector.¹³⁷ However, just as with the previous Plans, politics trumped economic principles when the bill arrived at the Majlis. Interestingly, it was the two ends of the political spectrum—the Islamic Marxists and “welfare ideologues” combined with “the bazaar and rent-endowed clerics”—in the Majlis and Guardians Council who found unique common ground in opposition to the Third Plan.¹³⁸

¹³⁴ Amuzegar, “Iran's Post-Revolutionary Planning,” 33.

¹³⁵ Evrand Abrahamian, *A History of Modern Iran* (London: Cambridge University Press, 2008), 187. Jahangir Amuzegar, *Iran's Third Development Plan: An Appraisal*, *Middle East Policy*, 12:3 (Fall 2005): 46.

¹³⁶ Amuzegar, *Iran's Third Development Plan*, 46.

¹³⁷ Amuzegar, *Iran's Third Development Plan*, 46.

¹³⁸ Amuzegar, *Iran's Third Development Plan*, 47.

This political interference resulted in the Third Development Plan losing much of the economic teeth it needed to implement reform. Specifically removed were the following provisions:

- Postponement of the retirement age; this would allow the government to save the government pension fund which was in bankruptcy.
- Establishment of a “means test” for groups receiving government subsidies. This would aid in reducing the ever-present budget deficits.
- An allowance of state enterprises to raise administrative prices in an attempt to recover some of their costs.
- An order ending tax exemptions for all public agencies and semi-public charitable foundations.
- A plan to gradually raise the highly subsidized energy prices to a level commensurate with international standards.¹³⁹

The result of all the contestation over the Plan resulted in a delay of seven months, and the Majlis finally ratified the Plan Law on 5 April 2000. The final document was a monolithic work of chapters, clauses, and sub-clauses that dealt with a myriad of “goals, means, directives, policies and appropriations in a convoluted and poorly organized format.”¹⁴⁰ And all this came at a significant financial cost, 804 trillion rials (\$114 billion) that would be financed from oil exports (\$60 billion), non-oil exports (\$34.5 billion) exports of “technical and engineering services” (\$7.5 billion), and credit and loans borrowed abroad (\$12 billion).¹⁴¹

The outcomes of the Third Development Plan, while somewhat mixed, were mostly negative. On the positive side, the annual real growth of oil and non-oil GDP was respectable (if slightly less than projected—see Appendix C), population growth fell to near its target value of 1.5%, real per-capita income rose by an average of 3.8% annually, and services and industry were the biggest contributors to GDP growth.¹⁴² Other performance factors were not as positive, however. Public and private consumption

¹³⁹ Amuzegar, *Iran’s Third Development Plan*, 47.

¹⁴⁰ Amuzegar, *Iran’s Third Development Plan*, 47.

¹⁴¹ Amuzegar, *Iran’s Third Development Plan*, 47.

¹⁴² Amuzegar, “Iran’s Third Development Plan,” 50. IMF, “Islamic Republic of Iran: Statistical Appendix.” *IMF Country Report No. 07/101* (March 2007): 3.

exceeded growth targets significantly (65–85%)¹⁴³ as the plan was unable to reduce growth in aggregate consumption in exchange for increasing fixed-capital formation. This resulted from greater credit and liquidity at the consumer level caused by plentiful oil receipts and new consumer habits of “one-upmanship” influenced by effective advertising.¹⁴⁴ Total investment as a percentage of GDP was also less than need to achieve the goal of full employment.

The Iranian government found success in some of its market-oriented reforms. The multiple exchange-rate system was, finally, unified in March 2002 and most current account restriction ended. Additionally, foreign trade liberalized as non-tariff barriers were rationalized into tariffs, export-licensing procedures were improved, and export restrictions lifted. Also, the Central Bank was modernized and authorized to issue “participation papers” (short-term government bonds) to contain inflation by mopping up excess liquidity. Finally, the government succeeded in tax code reformation and the creation of the Oil Stabilization Fund (OSF) to help absorb negative effects of oil price fluctuations.¹⁴⁵

The overall failure to meet many of the structural reform goals of the system, however, overshadowed what success there was in achieving specific quantitative targets.¹⁴⁶ Eleven failures resulted in the ultimate inability of the Third Development Plan to succeed:¹⁴⁷

¹⁴³ IMF, “Islamic Republic of Iran: Statistical Appendix,” *IMF Country Report No. 07/101* (March 2007): 11.

¹⁴⁴ Amuzegar, “Iran’s Third Development Plan,” 51.

¹⁴⁵ IMF, “Islamic Republic of Iran– Selected Issues,” *IMF Working Paper No. 04/308* (September 2004): 23. Amuzegar, “Iran’s Third Development Plan,” 52.

¹⁴⁶ IMF, “Islamic Republic of Iran– Selected Issues,” 57. (See Appendix D)

¹⁴⁷ Amuzegar, “Iran’s Third Development Plan,” 53–60. IMF, “Islamic Republic of Iran–Selected Issues,” 36.

- Failures to consolidate, reorganize, and downsize of the government's administrative bureaucracy. Government expenditure, as a ratio of GDP, actually *rose* from 1999 to 2004.
- Inability to control prices (either through cost-cutting or increased productivity).
- Poor results at privatization.
- Failure to end the subsidy system. Explicit and implicit subsidies are estimated by the World Bank to require 17% of GDP (5 and 12%, respectively).
- Failure to curb poverty.
- Continued lack of job opportunities. In fact, unemployment actually increased by some estimates.
- Failure to prevent continued budget deficits.
- Misuse and depletion of the Oil Stabilization Fund.
- Inability to protect the domestic currency, resulting in a steady decline in the rial against global currencies during the period, and a loss of 80% of real domestic purchasing power.
- Inability to reduce wasteful use of energy resources. Energy consumption rose 5 times more quickly than the global average during the period.
- Failure to set environmental protection and conservation policies.

As a result of these failures, many of the structural reforms of the Third Development Plan were never realized. During its period of implementation the government expanded in size and state institutions became less disciplined and more corrupt, all the while increasing its dependence on oil revenue.¹⁴⁸

4. The Fourth Development Plan: 2005–2009

March 2005 heralded the arrival of the Islamic Republic of Iran's Fourth Development Plan, the issuance of which coincided with the publication of "Iran's 20-Year Economic Perspective." This additional document detailed the long-term plans for Iran's development (economically, politically, socially, and culturally) through 2025. "The 20-Year Perspective" stated that, after four more development plans, Iran would use its Islamic revolutionary identity to assume the lead among 28 Middle East and Southeast

¹⁴⁸ Amuzegar, "Iran's Third Development Plan," 61.

Asian countries in economic, scientific, and technology issues.¹⁴⁹ The specific economic goals were the same, however, as those issued in the three preceding five-year plans. Fast-paced (and sustainable) economic growth, lowering unemployment, better factor productivity, operations in international markets, economic development with low inflation and food security, and creation of a successful entrepreneurial market environment were the 20-Year plan's objectives.

The Fourth Development Plan (which was the first in the 20-Year Perspective) was not, however, a very auspicious beginning. Rather, the Fourth Plan continued in the vein of the previous plans failures to make progress in developing the Iranian economy more than incrementally. As the Fourth Plan reached its designated expiration date a short three months ago, the academic community has yet to issue much in the way of comprehensive analysis of the specific successes, failures, or non-starts of the plan. An examination of broad macroeconomic data, however, can lead to some basic analysis of the general impacts of the plan.

Overall the plan had five basic goals: economic growth, price stability, lower unemployment, increased investment, and reduction of oil-export receipts as a percentage of the overall economy.¹⁵⁰

a. Economic Growth

Data for 2009 is still subject to reconciliation, though it is available for some sectors. Comprehensive data is available through 2008 and is sufficient to extrapolate performance for the remaining year of the Fourth Plan. As is indicated in Figure 2, GDP growth has occurred during the Fourth Plan period. Overwhelmingly, however, the boom in oil prices caused GDP growth as Iran's industrial and export sector did not produce significant improvements to production.¹⁵¹ Further, the GDP growth is

¹⁴⁹ Jahangir Amuzegar, "Iran's 20-Year Economic Perspective," *Middle East Policy*, 16:3. (Fall 2009): 41.

¹⁵⁰ Amuzegar, "Iran's 20-Year Economic Perspective," 41.

¹⁵¹ Anonymous, "Iran." *Oxford Economic Country Briefings: Iran* (August 19, 2009): 1–5. <http://www.proquest.com/> (accessed March 9, 2010).

expected to continue to shrink as oil revenues fell in 2009 along with the precipitous drop in the commodity's global price following its zenith in 2008.

In addition, stagnant total factor productivity proved a drag on economic performance as well. The Plan called for 2.5% of projected 8% GDP growth to be from increases in total factor productivity.¹⁵² In reality, while labor productivity rose and estimated 0.57% annually throughout the Plan, total factor productivity has declined due to low capital returns. This resulted, in large part, from the size of the government (with its lax supervision of state employees' productivity) in the private sector, lack of sufficient inputs for factories to operate at or near capacity, and the number of official holidays. These forces worked in concert to hinder total factor productivity increases.¹⁵³

(Annual percentage changes unless specified)				
Real GDP growth (% year)	7.8	3.5	0.7	3.0
CPI inflation (%)	17.2	25.5	14.2	9.0
Exports of goods (\$ bn)	97.4	101.8	82.6	97.7
Exports of services (\$ bn)	7.3	7.8	8.0	8.6
Imports of goods (\$ bn)	56.6	69.8	66.3	71.1
Imports of services (\$ bn)	15.6	17.0	16.2	17.2
Exports of goods (% year)	28.1	4.6	-18.9	18.4
Imports of goods (% year)	13.1	23.3	-5.0	7.3

Figure 2. Macroeconomic figures for Iran. Source: Oxford Economic Country Briefings¹⁵⁴

b. Price Stability

As seen in Figure 2, inflation decreased during the Fourth Plan, mainly as a result of lower food prices. These reductions are somewhat offset by currency depreciation and the gradual reduction of some government-provided subsidies.¹⁵⁵ In

¹⁵² Amuzegar, "Iran's 20-Year Economic Perspective," 47.

¹⁵³ Amuzegar, "Iran's 20-Year Economic Perspective," 47.

¹⁵⁴ Anonymous, "Iran," *Oxford Economic Country Briefings: Iran*, August 19, 2009, 1–5. Accessed 9 March 2010, <http://www.proquest.com/>

¹⁵⁵ Anonymous, "Iran," *Oxford Country Briefing*. 2.

addition, consumer prices rose during the plan.¹⁵⁶ Noteworthy is Iran's inflation in comparison with the rest of the MENA region (Figure 3).

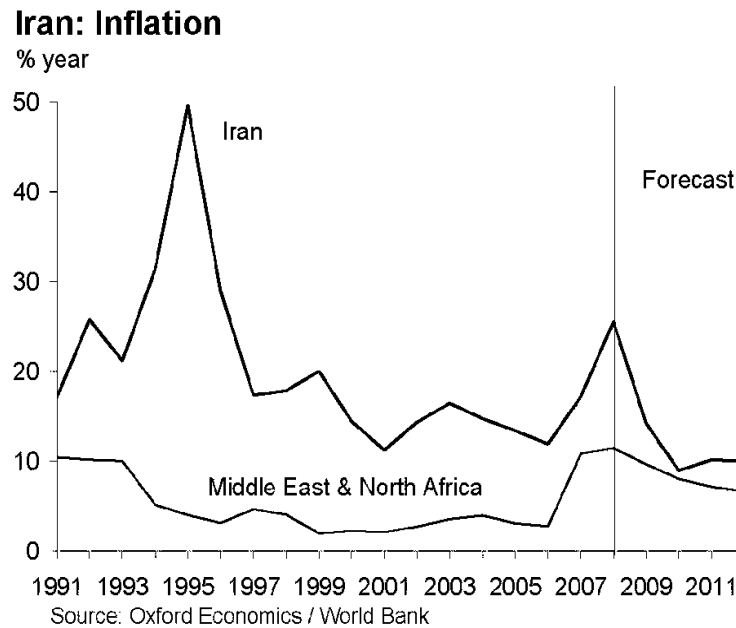


Figure 3. Iranian inflation compared with that of MENA overall. From Oxford Economics/World Bank¹⁵⁷

c. *Unemployment*

Job creation has consistently plagued the Iranian economic development plans. While there has been some success, in general the rate of creation has not kept pace with the rates of new labor in the market, and unemployment remains higher than desired.¹⁵⁸ This is significant for two reasons: first, due to the government's dominant role in the private sector, it alone bears almost the sole burden of creating jobs. Second, through the various development plans the government has included population growth

¹⁵⁶ IMF, "Islamic Republic of Iran: Statistical Appendix." *IMF Country Report No. 07/101* (March 2007): 21.

¹⁵⁷ Anonymous, "Iran," *Oxford Country Briefing*, 3.

¹⁵⁸ CIA World Factbook.

control as a targeted goal. The campaigns have been reasonably successful, yet the rates still remain too high with respect to the government's ability to create expanded employment opportunities.

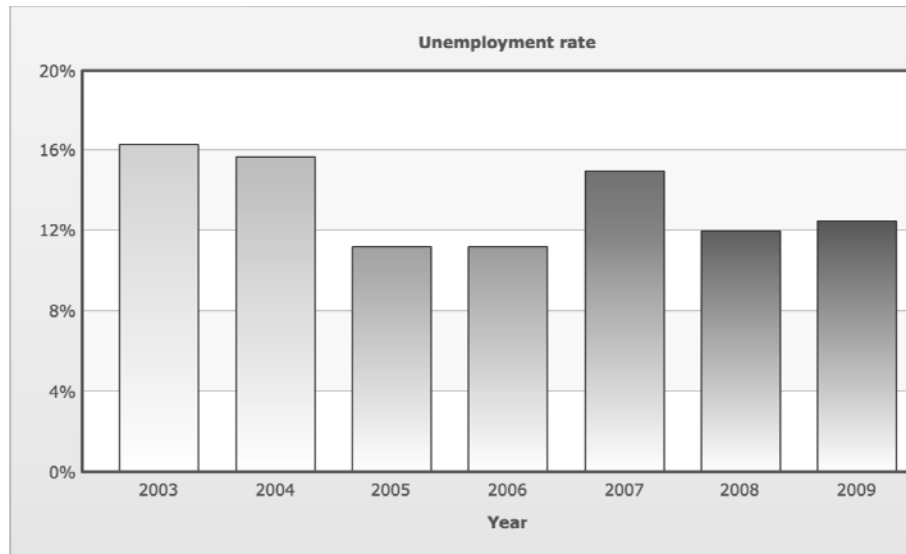


Figure 4. Unemployment rate trends in Iran. From Index Mundi data provided by figures in CIA World Fact Book¹⁵⁹

d. Increased Investment

Many factors have traditionally impaired growth in economic investment in Iran. The significant presence of the state in the Iranian economy is one of the most notable. Private investors (few that there are) are understandably wary of committing their finances to government corporate schemes, and entrepreneurs face significant obstacles to entering the market. Data indicates that both the time required to start a business, as well as market capitalization of listed companies (as a percentage of GDP), remains anemic (see Appendix E).¹⁶⁰

¹⁵⁹ Index Mundi, "Iran Unemployment Rate" (19 February 2009) accessed 10 March 2010, http://www.indexmundi.com/iran/unemployment_rate.html.

¹⁶⁰ WTO World Development Indicators database, September 2009.

e. Reduced Dependence on Oil

The goal of reducing dependence on oil exports as the largest source of national income achieved the same poor showing during the Fourth Plan as did the other goals. In fact, the opposite likely occurred as the oil boom of 2008 resulted in dramatic rises in revenue in a remarkably short time period. Ironically, had the government operated its Oil Stabilization Fund honestly and in good faith, the period could have provided significant resources for the government to either bolster national income when the price fell again, or to use on economic development and diversification projects. By the end of the Fourth Development Plan, oil today accounts for almost 70% of Iran's state finances and 80% of its foreign exchange earnings.¹⁶¹

Thus, the Fourth Development Plan ended its tenure in a similar fashion to its predecessors. While the country made some minor economic gains, the economy itself remained underdeveloped in terms of production and diversity, over-reliant on oil exports to provide currency and rents to support government social programs, and hindered by the over-representation of government in the private sector.

D. RELATIVE DEVELOPMENT SUCCESSES

One must look at the development successes achieved by Iran in some areas and compare these with development failures to get a sense of the overall nature of the Iranian development problem. Using data between 2000 and 2008, one sees some areas of sustained improvement of the economy in specific areas consistent with development (though not necessarily of market-oriented reforms). The first relative success is in the effort to curb population growth. The overall birth rate in 2008 was at 1.3, and this was consistent with a steady decline throughout the period that is also shown the declines of total and adolescent fertility rates between 2000 and 2008 (Appendix E). Further, the government apparently achieved these reductions through education and access to contraception rather than coercive means found elsewhere. This signals the

¹⁶¹ Amuzegar, "Iran's 20-Year Economic Perspective," 45.

government's understanding of the need to control population growth rates that often exacerbate the efforts of economic development elsewhere in the region.

The second area of relative success is found in the composition of the output of the broader economic sector. Agriculture, as a share of the economy, decreased from 14% of gross domestic product in 2000 to 10% of GDP in 2008 (Appendix E). This decrease is in line with the increase in industry's share of the economy, from 37% in 2000 to 45% in 2008, and corresponds to the first broad structural change required for economic development—that of the relative decline of agriculture and relative increase of industrial output as a share of the total economy.¹⁶² Additionally, exports rose 10% from 23% of GDP to 33% during the same period (Appendix E). Although the indicators for the agricultural and industrial sectors are consistent with a developing economy (moving from rural-centric agricultural to urban industrial), the export numbers need to be interpreted carefully, as the period of increase in exports as a percentage of GDP coincides with a significant increase in the price of oil, the country's main export. Determining whether the increase in export revenue was achieved through simple commodity price increase, or increased production of non-oil commodities, requires further research.

Aggregate numbers of gross domestic product increases are open to interpretation as to whether or not they signify true economic development. GDP grew positively during the period of 2000–2008 (Appendix E). However, with the exception of 2007—in which the 7.8% GDP growth is less significant due the high rates of inflation during that time (Figure 3)—growth averaged around 5% during 2000–2008. This is less than the 7% the Spence Report states as the standard for high growth countries. The combination in 2007 of GDP and inflation increases corresponds with a period of significant growth in international oil prices (Figure 1). This weakens the argument that GDP growth on its own is a reliable indicator of economic development and also proves the danger of relying solely on GDP figures as a goal-setting mechanism for economic structural changes.

¹⁶² Perkins et al., 97.

E. DEVELOPMENTAL FAILURES

On the whole, the Iranian economy suffered more failures with regard to economic development than it did successes. The first failure relates to the successes achieved in lowering the share of agricultural output and raising the share of industrial output of the broader economy. To fully meet Perkins et al.'s requirements, the share of services must also increase as a factor of overall production. In Iran, however, the share of services fell from 50% in 2000 to 45% in 2008 (Appendix E). While the decline is small, it is consistent over time and shows little sign of trending upward as the share of oil production as percentage of the economy remains high.

Many additional data points correspond to a failure of economic development. Gross capital formation declined slightly from 2000 to 2008, from 33% to 31% (Appendix E). This relative flat line is inconsistent with the type of increase in private investment in the economy that the Iranian Five Year Development Plans targeted. Remittances increased substantially during the period as well, up from (US)\$536 million in 2000 to (US)\$1,115 million in 2008 (Appendix E). While this period corresponds to an overall period of global growth and prosperity, which is likely responsible for a sizeable share of the increase, the scale of the increase (a near doubling) without such a comparable increase in the domestic economy indicates that the share of remittances of the overall economy rose disproportionately.

Anemic performance is also found in the market capitalization of listed companies. Though there has been an increase from 2000 to 2008 (from just above 7% to slightly over 12%), both the low percentages as well as the inconsistencies year-on-year indicate the failure of the Iranian government to reduce its involvement in the private sector. Far from it, agencies within the government—specifically the Islamic Revolutionary Guard (IRGC) and their popular militia, the *basij*—have become more involved in the economy since the 2005 election of Mahmoud Ahmadinejad as President of Iran.

The problem of inflation has remained a bane to Iranian economic planners as well. After reaching egregious rates of 50% in 1995, the rate declined somewhat, but has remain persistently between 15% and 25% through the end of the '90s and throughout the

present decade (Figure 3). Highlighting the failure of the economic planners are the changes of 5% and more from year to year until the second half of this decade where it appears the surge in oil prices have, once again, resulted in correspondingly higher inflation. Inflation climbed from 17% in 2005 to 25% in 2008, and prospects for 2009 are not encouraging (Appendix E). Iran's attempts to reduce the effects of commodity price fluctuation on the economy by reducing the share of oil have ultimately failed.

It would seem that the failures in Iran's structural adjustments stem from an improper focus solely on results and not methods. The central economic planners responsible for the iterations of the Five-Year Development Plans concentrated the majority of their effort in setting targets for the various sectors of the economy to meet. While setting development goals is appropriate and required in economic planning, equally important is a focus on the methods—or specific regulatory, environmental, policy, or political changes to the structure of the economy—required to achieve those goals. In addition to a lack of coherent change planning, what structural adjustments that were made by the economic experts had their effectiveness diluted by ideological interests when the proposals were put before the Majlis and Council of Guardians. In these organizations (as well as the Presidency, since 2005) a political and ideological philosophy that puts the tenets of Khomeini's revolutionary ideas ahead of economic development necessities has subordinated the potential of the five-year Plans.

What is perhaps more damaging is that the structural reforms that were achieved during the first three Plans are currently being reduced by the increasingly interventionist role the government is taking in the economy. Both in indirect ways such as “crony capitalism,”¹⁶³ and in more direct methods like increasing rates of ownership by agents of the Iranian Revolutionary Guard of corporations in the private sector,¹⁶⁴ the government is moving farther from its consistent developmental goals of reducing government's role in the economy. When the actions taken by the Iranian regime since 2005 are examined in comparison with the Spence Report's findings of common

¹⁶³ Robert Looney, “The Iranian Economy: Crony Capitalism in Islamic Garb.” *The Milken Review* (First Quarter 2006): 28–37.

characteristics of sustained high growth cases, specifically the crucial elements of market decentralization combined with effective governance (that is a government that acts “in the interests of all the citizens of the country—as opposed to itself or subgroups”),¹⁶⁵ one can see that the Iranian economy is moving farther away from its economic development goals, not closer.

¹⁶⁴ Amir Taheri, “Who are Iran’s Revolutionary Guards?” *The Wall Street Journal* (15 November 2007)

¹⁶⁵ Spence, “The Growth Report,” 11.

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V. CONCLUSION

The people of Iran undertook the 1979 Islamic Revolution for a multitude of reasons as disparate as the population of Iran itself. The emergence of Ayatollah Khomeini as the spiritual and intellectual figurehead of the Islamic Republic ensured that the generally accepted narrative both internally and externally was the theological one. But economic factors under the Pahlavi regime, many of them familiar issues in developing economies moving from rural to industrial economies (unemployment from rural to urban migration, increase in wealth disparity between rich and poor, and others), played a key role in sparking the revolution that overthrew the Shah. The attempt to transform Iran into a totally Islamic Republic included serious intellectual and philosophical debate regarding the construction of an Islamic economic system. This debate was heavily influenced from elements with left-leaning ideologies, such as Marxists and classically (secularly) trained economists, whose beliefs dovetailed with the concepts of social justice and equality held by the Islamic religious scholars, such as Muhammad Baqr al-Sadr and Ali Shariati.

As a result, the method of central economic planning used under the Shah was kept much the same in the Islamic Republic; however, Khomeini's ideals of Islamic theology legitimized the increased participatory role of the state in the economy. Further, Khomeini's interpretations allowed the state to pursue authoritarian measures by declaring the Imam (and thus the state) the final arbiter of how much private property is appropriate before it becomes a threat to social harmony. Khomeini himself appeared at times to favor both a leftist view of state participation in the economy and a more *laissez faire* approach of letting private enterprise operate freely. His political architecture reflected this, with the *Majlis* ultimately being the representative body endorsing more populist strategies, and the Guardian Council composed of *bazaaris* and more market-oriented *ulama*. The resulting political deadlock, however, could only be broken by Khomeini and has remained a shackle on Iran's economic development in the decades since Khomeini's death.

A. OIL MEANS MONEY, NOT DEVELOPMENT

The increase in Gross Domestic Product performance, particularly in the last decade, reflects (almost solely) the rise in the international commodity price of oil. As a result, the Iranian economy has not developed in a broad spectrum way equitable with its GDP increases. In fact, Iran is now representative of a class of rentier states that fail to use hydrocarbon rents to generate investment and instead use it to heavily subsidize life for the general population to buy political quietism in the face of authoritarian government actions.

This investment failure is ultimately self-defeating, as the lack of resources allocated to the productive sectors of the economy ultimately means that the hydrocarbon sector itself is negatively affected. As it stands today, Iran's oil and natural gas industries are hobbled by antiquated technology, a lack of skilled workers and engineers, and an inability to capitalize on available resources. Iranian oil companies are unable to fully exploit available oil and gas deposits, even compared with relative performance under the Shah. The Iranians, it is believed, will be unable to fully capitalize on recent discoveries of new fields in the Arabian Gulf as a result of decades of neglect of proper equipment and training. This neglect has not only hurt the hydrocarbon extraction and production capabilities, but has most severely affected refinement as well.¹⁶⁶

As a result of a lack of proper investment, Iran today is a net importer of gasoline and this has direct effect on consumers and the wider economy in general. Common among hydrocarbon rentier states is the belief that the oil in the ground is a "gift" that ought to directly benefit all the people in a country; and one of the ways this idea is expressed is in the belief that fuel should be considerably cheaper (after all, should not the people have right to the commodity first, before it is sold abroad?). This is the case in Iran, where gasoline is heavily subsidized by the government, even as it actually imports more than it produces. This, along with many other subsidies, is a significant burden on the state's capacity to invest in other sectors of the economy. And since, in Iran, large

¹⁶⁶ Carlos Hoyos, "Sanctions choke supply of petrol to Iran," *Financial Times* (12 August 2010): 3.

amounts of capital almost solely reside with the state (for ideological and political reasons described in Chapter III), there are no other significant sources of potential large-scale investment.

Further exacerbating the problem is the lack of foreign investment in the Iranian private sector, owing to a combination of the ideological beliefs carried over from the Islamic revolution and external sanctions brought on by the activities of the Iranian government in nuclear weapons research and support of terrorist organizations. Until the government can significantly reduce its outlay on subsidies—unlikely, given the current regime’s reliance on other populist policies—any further increases in GDP resulting from the rise in oil prices are likely to have little effect on the overall state of the economic development in Iran.¹⁶⁷

B. THE DELETERIOUS EFFECT OF SANCTIONS

The current regime in Iran has imposed another severe burden on the Iranian economy, though not one resulting from poor economic planning or misappropriation of resources. Since the government of Iran admitted in 2003 to a uranium enrichment program that violated its agreements under the Nuclear Nonproliferation Treaty (NPT), the United States has pursued both unilateral and multilateral sanctions in an attempt to coerce the Iranian government to abandon its perceived pursuit of nuclear weapons. These sanctions, which have increased in scope to target significant proportions of the overall Iranian economy, have exacerbated the negative effects of Iran’s poor development. Specifically, Iran’s reliance on crude oil exports for 70% of the government’s budget and extensive ownership of private corporations by the IRGC provide easy and effective targets for international sanctions. Due to a low tax base (an estimated 50% of the economy is tax-exempt) and high unemployment, the government

¹⁶⁷ Jahangir Amuzegar, “Iran’s Economy in Turmoil,” *International Economic Bulletin* (March 2010) Downloaded 21 May 2010 from the Carnegie Endowment for International Peace, www.carnegieendowment.org

is significantly dependent on the revenue from oil exports and state-owned agencies.¹⁶⁸ The domestic private economy lacks the capacity to support the government's programs and subsidies indigenously.

A significant example has already occurred in the wake of the most recent round of international sanctions. The direct sanctions themselves, as well as pressure on international corporations not technically bound by the sanctions to "not fill the void" left by the U.S. and others, has resulted in the government of Iran paying a 25% premium above market price for gasoline deliveries from outside the country.¹⁶⁹ Considering the high amount of gasoline imported, as well as the significant subsidies already provided to the public for domestic gasoline use, the impact will be significant. As a response, the government has begun hoarding supplies and rationing gas sales to the public as it attempts to boost domestic production—a dubious undertaking considering the state of the infrastructure previously described. Even if the Iranian government can, as it promises, replace 75% of its imported fuel,¹⁷⁰ the cost to the government in terms of premiums on the remaining imported amount as well as in opportunity (and real) costs as resources are diverted from other economic sectors will be serious. And this is but one sector of many in the economy that will likely be similarly affected.

C. THE END OF THE REVOLUTION FOR ISLAMIC ECONOMICS IN IRAN

Ultimately, the only certain fact of Iran's economic future is that it is uncertain. While significant damage has been done in the name of populism, pragmatists and free-market proponents still exist and vie for power within the system. A notable fact following the disputed 2009 presidential elections in Iran is that some of the most significant opposition figures were the ones responsible for previous attempts at economic reform. It is also important to understand that it is possible for an ideology that supports the idea of the Islamic Republic of Iran also to value the principles of a market

¹⁶⁸ Amuzegar, "Iran's Economy in Turmoil."

¹⁶⁹ Hoyos, "Sanctions Choke Supply," 2010.

¹⁷⁰ Hoyos, "Sanctions Choke Supply," 2010.

economy, private property, and economic development. Islamic economic theory is fully compatible with capitalism, provided certain philosophical boundaries are adhered to.

In the end, Iran's economic failures following the revolution are not the result of a failure of Islamic economic theory. Those ideals, ultimately, were never fully instituted. Instead, Ayatollah Khomeini's version of government after the Revolution created a system dependent on his own personal ideology to function. That system—of parallel religious and government institutions, diametrically opposed legislative bodies (neither with the inherent ability to overrule the other—ultimately subordinated to the rule of a successor lacking either the charismatic or intellectual legitimacy to stand alone meant that economic development was always shorted by influential populists. This outcome is often found in other countries that are unable to resist the “curse” of natural resource endowments. Ultimately, Iran's poor economic showing is not the result of a failure of Islamic economics; instead, it is classic case of the perils of rentier economics consistent with many other countries whose natural resource endowments become catalysts for populist economic curses.

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APPENDIX A: TARGETS AND OUTCOMES OF SECOND DEVELOPMENT PLAN

Table 1. Targets and outcomes of Second Development Plan¹⁷¹

Targets and Outcomes of the Second Development Plan (1995-2000)												
(percentage change)												
Basic Indicators	1374		1375		1376		1377		1378		1374-78	
	(1995/6)		(1996/7)		(1997/8)		(1998/00)		(1999/00)		(1995-2000)	
	T*	A	T	A	T	A	T	A	T	A	T	A
Gross Domestic Product	5.1	3.2	5.1	4.7	5.1	3.1	5.1	2.1	5.1	2.4	5.1	3.8
Agriculture	4.3	2.3	4.3	3.7	4.3	3.5	4.3	9.5	4.3	-0.3	4.3	3.7
Oil & Gas	1.6	0.9	1.6	1.9	1.6	-5.3	1.6	-0.8	1.6	-1.0	1.6	-0.9
Industry & Mines	5.9	5.5	5.9	7.8	5.9	5.4	5.9	0.1	5.9	4.4	5.9	4.6
Services	3.1	3.4	3.1	5.0	3.1	5.1	3.1	-0.2	3.1	4.3	3.1	3.5
Gross Domestic Expenditure	5.1	10.7	5.1	1.1	5.1	5.9	5.1	4.2	5.1	1.7	5.1	3.8
Private Consumption	4.0	-4.8	4.0	11.0	4.0	2.7	4.0	2.5	4.0	3.1	4.0	2.8
Public Consumption	-0.9	3.2	-0.9	6.1	-0.9	3.3	-0.9	2.0	-0.9	6.8	-0.9	4.2
Gross Investment	6.2	3.8	6.2	7.8	6.2	-0.2	6.2	-6.3	6.2	8.2	6.2	2.5
Oil Exports	3.4	-5.6	3.4	21.9	3.4	-18.0	3.4	-29.3	3.4	50.3	3.4	2.2
Non-Oil Exports	8.4	-32.6	8.4	-4.3	8.4	-6.8	8.4	9.4	8.4	8.5	8.4	-6.5
Imports	4.3	1.2	4.3	17.3	4.3	-5.8	4.3	1.1	4.3	-5.5	4.3	1.4
Employment	2.7	...	2.7	...	2.7	0.01	2.7	0.006	2.7	...	2.7	0.02
Broad Money	12.5	36.8	12.5	36.7	12.5	10.0	12.5	25.7	12.5	20.2	12.5	25.5
Consumer Price Index	12.4	49.4	12.4	23.2	12.4	17.3	12.4	20.0	12.4	20.4	12.4	25.5
Government Revenue	15.2	34.3	15.2	37.8	15.2	12.9	15.2	-9.0	15.2	58.7	15.2	25.9
Government Expenditure	15.2	43.0	15.2	29.4	15.2	15.6	15.2	10.3	15.2	31.7	15.2	26.9

* T: Target, A: Actual

Source: Central Bank of the Islamic Republic of Iran: *Annual Reports* and *Quarterly Economic Trends*; Plan and Budget Organization: *Annual Reports* and plan documents; International Monetary Fund: *International Financial Statistics* and annual consultation reports; and author's estimates.

¹⁷¹ Jahangir Amuzegar, "Iran's Post-Revolutionary Planning: The Second Try," *Middle East Policy*, III:1 (March 2001): 30.

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APPENDIX B: ECONOMIC PERFORMANCE DURING THE FOURTH DEVELOPMENT PLAN

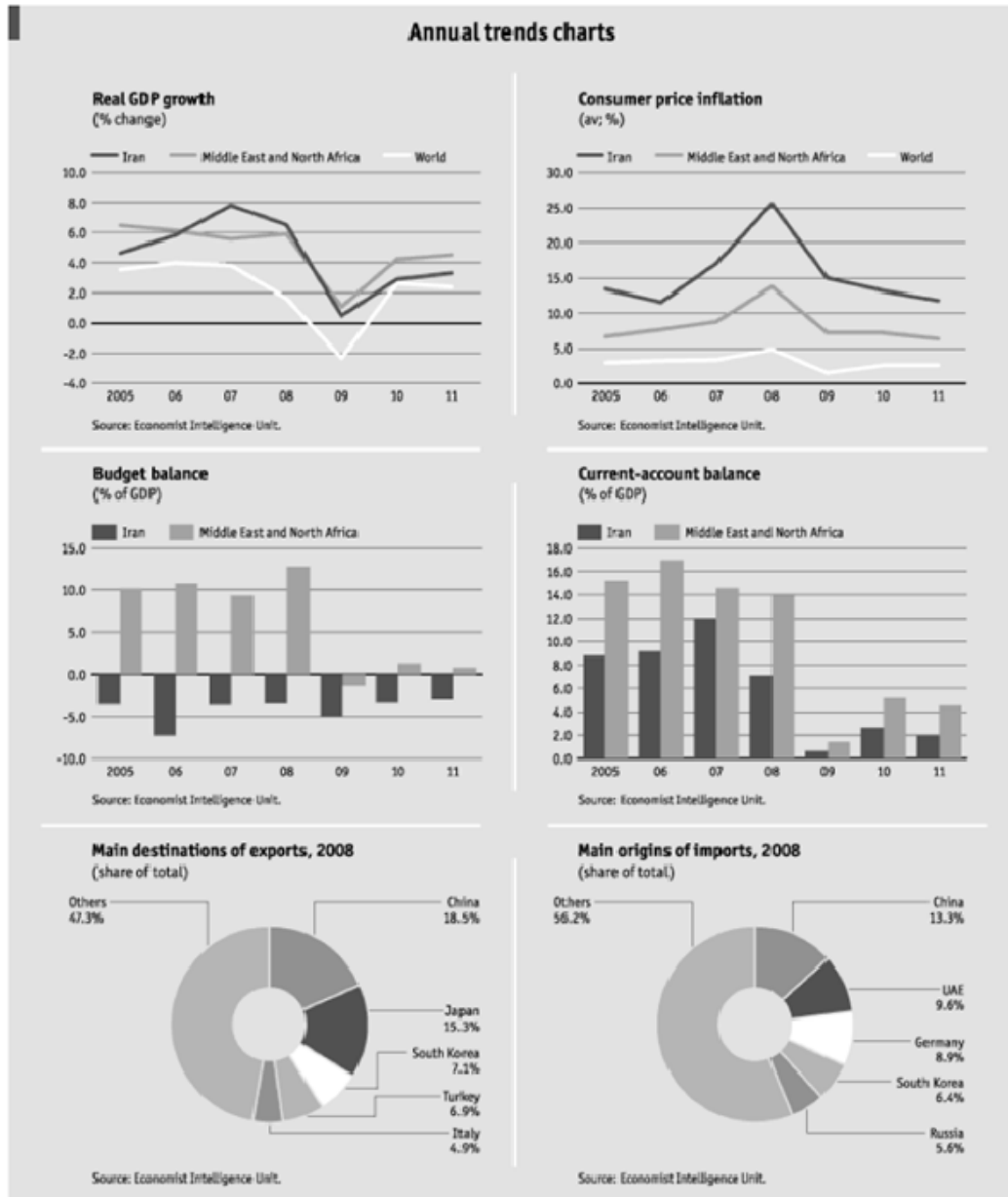


Figure 5. Economic performance during the Fourth Development Plan. From Economist Intelligence Unit (CIAO/EIU Partnership)¹⁷²

¹⁷² Economist Intelligence Unit (CIAO/EIU Partnership), "Iran: Economic Structure," (20 January 2010) accessed 4 March 2010, http://www.ciaonet.org/atlas/IR/Economy/Economic_structure/20100120_33772.html.

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APPENDIX C: ECONOMIC PERFORMANCE DURING THE THIRD DEVELOPMENT PLAN

Table 2. Performance of the Iranian economy during the Third Development Plan. From Amuzegar¹⁷³

Third Plan Performance: 1379-1383 [1999-2000 – 2004-2005] Average % change per annum

	<i>Target</i>	<i>Actual</i>
Gross Domestic Product (GDP)	6.2	5.4
Non-Oil GDP	6.8	5.8
Fixed Gross Capital Formation	7.1	9.3
Public	4.96	9.4
Private	8.5	13.0
Aggregate Consumption	3.0	6.6
Public	2.5	4.1
Private	3.5	6.5
Unemployment	14.0	12.5
Inflation (CPI)	15.9	14.1
Liquidity (M2)	16.4	28.9
Exports (goods)	6.2	17.2
Oil and Gas	0.9	17.4
Non-oil Exports	15.0	13.2
Imports (goods)	10.0	22.2
Population	1.5	1.6

Source: Management and Plan Organization; the Central Bank and author's estimate

¹⁷³ Amuzegar, "Iran's Third Development Plan," 49.

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APPENDIX D: MONETARY TARGETS

Table 3. Islamic Republic of Iran monetary targets, 1989/90–2004/5. From IMF Country Report No. 04/308¹⁷⁴

(Percentage change)

	1989/90–1993/94		1995/96–1999/2000		2000/01–2004/05	
	Plan I	Outcome	Plan II	Outcome	Plan III	Outcome 1/
GDP 2/	8.1	7.4	5.1	3.3	6.0	5.6
M2	8.2	24.1	12.5	25.5	16.4	29.1
CPI	14.8	18.7	12.4	26.2	15.9	13.9

Sources: Central Bank of Iran Iran; and Fund staff estimates.

1/ Four-year averages, 2000/01–2003/04.

2/ At factor cost at constant 1997/98 prices.

¹⁷⁴ IMF, “Islamic Republic of Iran- Selected Issues,” *IMF Working Paper No. 04/308*, September 2004, Accessed 2 March 2010, www.imf.org, 57.

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APPENDIX E: THIRD AND FOURTH DEVELOPMENT PLAN ECONOMIC DEVELOPMENT INDICATORS

Table 4. Iran development indicators for Third and Fourth Development periods. From World Trade Database, 2009¹⁷⁵

	2000	2005	2007	2008
World view				
Population, total (millions)	63.94	69.09	71.02	71.96
Population growth (annual %)	1.6	1.5	1.3	1.3
Surface area (sq. km) (thousands)	1,745.2	1,745.2	1,745.2	1,745.2
Poverty headcount ratio at national poverty line (% of population)	..	..	..	..
GNI, Atlas method (current US\$) (billions)	106.66	177.63	251.49	..
GNI per capita, Atlas method (current US\$)	1,670	2,570	3,540	..
GNI, PPP (current international \$) (billions)	433.99	631.73	769.72	..
GNI per capita, PPP (current international \$)	6,790	9,140	10,840	..
People				
Income share held by lowest 20%	..	6.4	..	..
Life expectancy at birth, total (years)	69	70	71	..
Fertility rate, total (births per woman)	2.3	2.1	2.0	..
Adolescent fertility rate (births per 1,000 women ages 15-19)	33	21	18	..
Contraceptive prevalence (% of women ages 15-49)	74	79	..	..
Births attended by skilled health staff (% of total)	90	97	..	..
Mortality rate, under-5 (per 1,000)	44	36	33	..
Malnutrition prevalence, weight for age (% of children under 5)	..	..	..	..
Immunization, measles (% of children ages 12-23 months)	99	94	97	..
Primary completion rate, total (% of relevant age group)	90	96	105	..

¹⁷⁵ WTO World Development Indicators database, "Iran," (September 2009) accessed 9 March 2010, www.wto.org

Ratio of girls to boys in primary and secondary education (%)	95	105	..	..
Prevalence of HIV, total (% of population ages 15-49)	0.1	0.2	0.2	..
Environment				
Forest area (sq. km) (thousands)	110.8	110.8	..	..
Agricultural land (% of land area)	39.0	29.2	..	..
Renewable internal freshwater resources per capita (cubic meters)	..	..	1,809	..
Improved water source (% of population with access)	94	..	..	..
Improved sanitation facilities, urban (% of urban population with access)	86	..	..	..
Energy use (kg of oil equivalent per capita)	1,858	2,288	..	..
CO2 emissions (metric tons per capita)	5.3	6.5	..	..
Elec.pwr consumption (kWh per capita)	1,586	2,117	..	..
Economy				
GDP (current US\$) (billions)	101.29	192.01	286.06	385.14
GDP growth (annual %)	5.1	4.6	7.8	5.6
Inflation, GDP deflator (annual %)	26.4	17.0	20.5	25.0
Agriculture, value added (% of GDP)	14	10	10	10
Industry, value added (% of GDP)	37	45	44	45
Services, etc., value added (% of GDP)	50	45	45	45
Exports of goods and services (% of GDP)	23	33	32	33
Imports of goods and services (% of GDP)	17	25	22	23
Gross capital formation (% of GDP)	33	33	33	31
Revenue, excluding grants (% of GDP)	23.4	36.5	37.2	38.5
Cash surplus/deficit (% of GDP)	1.8	6.0	10.6	12.1
States and markets				
Time required to start a business (days)	..	28	28	28
Market capitalization of listed companies (% of GDP)	7.3	20.2	15.9	12.7
Military expenditure (% of GDP)	3.8	3.8	2.9	2.5
Mobile cellular subscriptions (per 100 people)	2	12	42	60
Internet users (per 100 people)	1.0	17.8	18.3	32.0
Roads, paved (% of total roads)	..	..	..	..
High-technology exports (% of manufactured exports)	2	3	..	..

Global links				
Merchandise trade (% of GDP)	42.1	50.1	46.7	45.1
Net barter terms of trade (2000 = 100)	100	139	160	..
External debt stocks, total (DOD, current US\$) (millions)	7,978	21,260	20,577	..
Total debt service (% of exports of goods, services and income)	10.7	..	..	..
Net migration (thousands)	-56	-993	..	..
Workers' remittances and compensation of employees, received (current US\$) (millions)	536	1,032	1,115	1,115
Foreign direct investment, net inflows (BoP, current US\$) (millions)	39	918	754	..
Official development assistance and official aid (current US\$) (millions)	130	104	102	..

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